In the Supreme Court
OF THE
United States

October Term 1975

No. 75-1300

Touche Ross & Co., *Petitioner*,

vs.

Leonard Barrack, et al., *Respondents*.

PETITION FOR WRIT OF CERTIORARI
to the United States Court of Appeals
for the Ninth Circuit

William W. Godward,
Michael Traynor,
Cooley, Godward, Castro,
Huddleson & Tatum,
One Maritime Plaza,
San Francisco, California 94111
Telephone: (415) 981-5252,
Attorneys for Petitioner
Touche Ross & Co.

Richard H. Murray,
1633 Broadway,
New York, New York 10019,
Telephone: (212) 489-1600,
Of Counsel.

PERNAU-WALSH PRINTING CO. - 562 MISSION STREET - SAN FRANCISCO, CA 94105

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PETITION FOR WRIT OF CERTIORARI to the United States Court of Appeals for the Ninth Circuit

Petitioner Touche Ross & Co. hereby petitions for a writ of certiorari to review the judgment and decision of the United States Court of Appeals for the Ninth Circuit entered in this case on September 25, 1975.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Ninth Circuit to which this petition is addressed, is officially reported at 524 F.2d 891; a copy of the opinion is printed in the Appendix to this petition at page 1.

The opinion of the United States District Court for the Northern District of California, which was the subject of the appeal to the Ninth Circuit is not officially reported; a copy of that opinion is printed in the Appendix at page 45.

JURISDICTION

The order of the Ninth Circuit dismissing the appeal of Touche Ross & Co. was entered on September 25, 1975. A petition for rehearing *in banc* was filed on October 9, 1975 and denied by order entered on December 16, 1975. A copy of that order is printed in the Appendix at page 57.

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISIONS, STATUTES AND RULES INVOLVED

The constitutional provisions, statutes and rules involved herein are the Fifth Amendment to the United States Constitution, 28 U.S.C. § 1291, the Rules Enabling Act (28 U.S.C. § 2072), Rule 23 of the Federal Rules of Civil Procedure, Sections 10(b) and 13 of the Securities Exchange Act of 1934 (15 U.S.C. §§ 78j(b) and 78m(a)) and Rule 10b-5 (17 CFR § 240. 10(b)-5). The text of each is set forth in the Appendix at pages 59 through 77.

STATEMENT OF THE CASE

This litigation involves eight purported class action suits consolidated for pretrial proceedings in the Northern District of California. All arise out of financial reverses experienced by Ampex Corporation in calendar years 1971 and 1972 from which it has now recovered.

The plaintiffs seek recovery under Sections 10 and 13 of the Securities Exchange Act of 1934, and Rule 10b-5. The complaint charges the defendants with misrepresentation of the financial status of Ampex causing an artificial inflation of the value of Ampex securities. The known plaintiffs allegedly purchased Ampex securities in a period from August 1970 to early January 1972.

The defendants fall into three categories:

(1) Ampex Corporation, a continuing business entity whose shares are traded on the New York Stock Exchange;

(2) Certain officers and directors of Ampex Corporation, and certain former officers and directors who are separately represented;

(3) Touche Ross & Co., independent certified public accountants engaged by Ampex Corporation during the years in question to render certain specific services during limited periods.

The first two categories of defendants are charged with primary responsibility for the misrepresentations and Touche Ross & Co. as an aider and abettor thereof. No personal gain is alleged against the defendants by reason of the alleged misrepresentations.

The record below, although sparse, indicates that the plaintiffs intend to build their case around some 45 documents issued by Ampex during the class period. Two of the documents were annual reports for fiscal years 1971 and 1972, which contain auditor's reports issued by Touche Ross & Co.; the remaining documents included quarterlies, financial reports, press releases, none of which contained audited data, nor was Touche Ross & Co. otherwise associated with them.

The two annual reports were the last information in the market for four weeks and five weeks in 1970 and 1971, respectively, before new financial results of the next quarter were published. The market price of securities dropped upon announcement of each of the annual reports, but climbed upon announcement of the first quarter earnings of the next fiscal year.

On April 10, 1974, the District Court granted plaintiffs' motion for class action standing covering the 27-month period from May 2, 1970 to August 3, 1972 as to all defendants. The Court acted without the benefit of testimony or significant or verified data addressed to the class issues.

On January 10, 1975, Touche Ross & Co. and certain of the individual defendants appealed from the class action order under the provisions of 28 U.S.C. § 1291; other defendants were granted rights of appeal under 28 U.S.C. §1292(b).

On September 25, 1975, the Court of Appeals for the Ninth Circuit dismissed the Section 1291 appeals as not presenting appealable final orders, and affirmed

the class action certification on its merits in the Section 1292(b) appeals. All defendants filed timely petitions for rehearing *en banc* on or about October 9, 1975, which were denied on December 16, 1975.

QUESTIONS PRESENTED

Two questions are presented arising from the two portions of the decision:

(1) From the portion of the opinion dealing with Touche Ross & Co.'s appeal under § 1291:

Should a defendant in a securities act case have a right of appeal under § 1291 from a District Court's order granting of class action standing to the plaintiffs when such defendant, on remand to the District Court, will be subject to major changes in its substantive rights by reason of the decision of the Court of Appeals (under consolidated cases appealed under § 1292(b)) laying down general guidelines on interpretation of Rule 23 and the substantive law under Section 10b?

(2) From the portion of the opinion which, under the § 1292(b) appeal, reviewed the class determination ordered by the District Court:

Should plaintiffs who bring a 10b-5 class action be entitled to obtain a class certification if they merely allege or state in general terms that during the period independent, unrelated, material misrepresentations were made by defendants, and the alleged misrepresentations may involve a similar legal rule or duty, and be excused both on such motion and on trial from

any showing of reliance, causation, or culpability of the defendants, the sole issue in a 10b-5 case being proof of material error?

REASONS FOR GRANTING THE WRIT

This petition provides the Court with an appropriate opportunity:

(1) To review the conflict in the circuits as to the right of a defendant to a direct appeal under Section 1291.

(2) To stem a trend in class action decisions in litigation under the federal securities acts, to alter plaintiffs' and defendants' basic duties and rights by using interpretation of the class action rules of procedure to affect basic changes in the elements of 10b-5 litigation. This decision is an extreme example: The Ninth Circuit, in upholding the class determination in its § 1292(b) review, removes any real obligation from plaintiffs to make a showing on class determination, thus rendering the requirements on class motion meaningless. It requires only general, not particularized, allegations of misrepresentations in a period, and permits these misrepresentations to be unrelated; a common issue is found if a common rule of law may affect the divergent representations. It excuses plaintiffs from even a minimal showing on such elements as reliance, causation and culpability, and does so on the underlying assumption that none of these elements are required of a plaintiff and are

not part of a 10b-5 case: proof of material error is the only issue. The opinion thus concludes—although not in so many words—that 10b-5 is a case in the nature of absolute liability. Its avowed justification for this extreme stance is that Rule 23 was adopted to enforce securities laws, and the courts must favor plaintiffs to prevent defendants from escaping.

The decision of the Ninth Circuit mentioned in this paragraph 2 was not applied directly to defendant Touche Ross & Co., since its appeal was dismissed. The decision nevertheless sets forth standards which, if applied to Touche Ross & Co., may adversely affect it in further conduct of the case, alter its rights on the merits, and prohibit it from defending itself on a basis separate from other defendants although its duty to plaintiffs is different and its position among the defendants is unique.

Further, the decision, if it is to stand as law, will affect great numbers of other parties and cases involving huge sums and huge costs. The need for stability in this area of law is urgent, both on the procedural and the substantive issues. A decision so much at variance with current authority calls for review.

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1. APPEALABILITY UNDER § 1291

With the present case, the Ninth Circuit has denied appealability, and challenged the Second Circuit, declaring that the *Herbst* decision (*Herbst v. International Telephone & Telegraph Corporation,* 495 F.2d

1308 [1974] undercuts the Congressional purpose for Rule 23, is unsupported by empirical data (footnote 14), and in any event, invades the province of Congress.

In its direct and avowed conflict with decisions of the Second Circuit, it is out of line with *Cohen v. Beneficial Industrial Loan Corp.,* 337 U.S. 541 (1949), and *Eisen v. Carlisle & Jacquelin,* 417 U.S. 156 (1974) (*Eisen IV*), and reverts to earlier and obsolete cases such as *Walsh v. City of Detroit,* 412 F.2d 226 (6th Cir. 1969), and *Thill Securities Corp. v. New York Stock Exchange,* 469 F.2d 14 (7th Cir. 1972).

In *Eisen v. Carlisle & Jacquelin,* 479 F.2d 1005 (2d Cir. 1973) *(Eisen III)* and later in *Herbst v. International Telephone & Telegraph Corp., supra,* the Second Circuit developed the so-called "reverse death knell doctrine", granting the right of appeal in certain circumstances under the principles of *Cohen, supra.*

The right of appeal was acknowledged in *Eisen IV:*

> "At the outset we must decide whether the Court of Appeal in Eisen III had jurisdiction to review the District Court's orders permitting suit to proceed as a class action and allocating the cost of notice. Petitioner contends that it did not. *Respondents counter by asserting two independent bases for appellate jurisdiction: first, that the orders in question constituted a 'final' decision within the meaning of 28 USC § 1291* [*28 USCS § 1291*] and were therefore appealable as of right under that section; and second, that the Court of Appeals in Eisen II expressly retained juris-

> diction pending further development of a factual record on remand and that consequently no new jurisdictional basis was required for the decision in Eisen III. *Because we agree with the first ground asserted by respondents, we have no occasion to consider the second.*" (417 U.S. 156, 169-170 [footnote omitted].) (Italics added.)

The doctrine has been restated and clarified in more recent Second Circuit cases, which, while denying appeals in those cases underscored defendant's right of appeal. See *General Motors Corp. v. City of New York,* 501 F.2d 639 (2d Cir. 1974); *Handwerger v. Ginsberg,* 519 F.2d 1339 (2d Cir. 1975); and *Parkinson v. April Industries, Inc.,* 520 F.2d 650 (2d Cir. 1975).

The same principle has found recent recognition in other circuits. See *McSurely v. McClellan,* 521 F.2d 1024 (D.C. Cir. 1975), granting an appeal from a motion for summary judgment, and see *Grinnell v. Chamber of Commerce,* 519 F.2d 595 (1st Cir. 1975), denying an appeal from a discovery order. See also, *Jones v. Diamond,* 519 F.2d 1090 (5th Cir. 1975).

Touche Ross & Co. submits that it qualifies for appeal under these cases (despite the Ninth Circuit's comment to the contrary in footnote 8), and an appeal should have been granted. It further submits that the Court's denial of the right in toto, its open rejection of the Second Circuit cases, the denial of *Cohen* and *Eisen IV* principles, and conflict with views of the other circuits compel a review on this portion of the decision.

2. **NINTH CIRCUIT'S PROCEDURAL SHIFT OF BURDENS, CHANGE OF SUBSTANTIVE RIGHTS AND ALTERATION OF A 10b-5 CASE TO ONE OF ABSOLUTE LIABILITY.**

The Ninth Circuit has worked major changes in both procedural and substantive rights in order to preserve the plaintiffs' class standing, with the effect that a 10b-5 action is converted effectively to a case of *absolute liability.*

As summarized above, the Ninth Circuit has, in its zeal to support federal securities enforcement:

(1) decreed basic rule changes in the Rule 23 requirements for a plaintiff to obtain certification; and

(2) changed the elements of a 10b-5 case by eliminating reliance, causation and culpability so as to make the case, in fact, one of absolute liability.

The decision has relaxed to the point of abandonment the Rule 23 requirements of pleading and demonstrating a common question. For example, under this decision it is sufficient for the plaintiff to allege a "failure to create adequate reserves for uncollectable accounts receivable, and for contractually guaranteed royalty payments, and the overstatement of inventory" (page 904). It holds that no particular item of receivables, inventories or royalties need be identified nor need any other common thread be established or even asserted. Perhaps this relaxation of the Rule would be appropriate in connection with a small economic unit, but had the District Court taken evidence here, it would have found that Ampex at all times carried over $100 million in receivables of

myriad sorts, and similar amounts and varieties of inventory on sales of some $300 million annually.[1]

Despite this obvious diversity and complexity of subject matter, the Ninth Circuit declared that it is sufficient to support a class (and later to make out a prima facie case) to state in unverified pleadings or a brief that there were a series of independent, unrelated misrepresentations during a class period.[2] While

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[1]Rule 9b, which requires specifications of charges in fraud cases and normally assists orderly administration, is ignored.

The Court found these statements sufficient particularization but to permit these generalizations is in conflict with cases such as *Clark v. Thompson,* 206 F.Supp. 539, 542 (D.C. Miss. 1962), *affirmed* 313 F.2d 637 (5th Cir.), *cert. denied* 375 U.S. 951 (1963), which states that a plaintiff cannot maintain a class action by calling it one.

[2](a) At page 904:

"... Defendants misconceive the requirement for a class action; all that is required is a common issue of law or fact. Even were we to assume that the reserves were at some points during the period adequate, the class members still would be united by a common interest in the application to their unique situation of the accounting and legal principles requiring adequate reserves—*i.e.,* by a common question of law.[19]"

(b) *At footnote 18* (page 901):

"... Under that section class members may well be united in establishing liability for fraudulently creating an illusion of prosperity and false expectations, even if created by a variety of seemingly unrelated misrepresentations.

"Moreover, even when misrepresentations are unrelated, class members may share a common question of law or fact. Of course, if an early misrepresentation is undissipated, a later purchaser will present a common question even if another misrepresentation has intervened. But even if the effect of the earlier misrepresentation is dissipated, proof of the earlier misrepresentation may be relevant to the latter purchaser's case. Proof of the earlier fraud and its effects might be relevant circumstantially to establish duty standards, culpability, or damages regarding the later fraud; it would establish background information about the defendant common to both suits. Thus, even when unrelated misrepresentations are alleged as part of a common scheme, class members may share common forum avoids duplicative proof. That is a

much of the decision talks of a particular item repeated throughout, the Court of Appeals also says that it is not essential that the same misrepresentation be repeated (as was the case in *Grad v. Memorex Corp.*, 61 F.R.D. 88 (N.D. Cal. 1973) or that misrepresentations be cumulative (as was the case in *Fischer v. Kletz,* 41 F.R.D. 377, 381 (S.D.N.Y. 1966). Indeed, the Court specifically states that it does not matter if in some reports there was no misrepresentation on such an item (see page 904), a proposition profoundly disturbing to Touche Ross which hopes to demonstrate that the two audited reports during the class period were accurate.

The Court below attempts a further justification for its position on common questions by declaring that, even if the facts aren't common, a rule of law may suffice. The Court speaks (see page 904) of the need for common "applications" of a rule, but footnote 18 removes this apparent barrier by declaring that for class action tests it does not matter if the applications have anything in common. Thus, the Ninth Circuit holds that a class is established whenever a similar

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major purpose of a class action; the 'common question' requirement should be interpreted to obtain that objective. Naturally when the component misrepresentations of a 'course of conduct' fraud are unrelated, a great many more noncommon questions exist."

(c) At page 905:

"Moreover, because of the relative similarity of the various documents involved, the duty owed by a defendant with respect to such documents will probably be uniform or nearly so, further uniting the positions of all class purchasers."

rule of law is to be applied to unrelated facts even where the applications may be divergent.

This seems indeed a tenuous thread on which to hold together a divergent fact class with divergent defendants. If rules alone are sufficient to establish a class without regard to the divergence of applications, then all accounting cases by definition qualify for class action treatment. If (as decided below) common rules only suffice to make a class then no defendant can separate himself from an extended class responsibility no matter how little involved it may have been for activities during the class period. Nothing in the text of Rule 23 or in its legislative history suggests that Congress or the courts have so intended.

The fact that plaintiffs may have to reveal their charges is not enough to excuse them, or to shift the burden to defendants, and we find the straining to hold this class together without any rational basis dangerous in the extreme. See *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723 (1975). See also discussions in *Bio-Medical Sciences, Inc. v. Weinstein,* Fed.Sec.L.Rep. § 95,445 (S.D.N.Y. 1976).

Furthermore, to permit plaintiffs' class, the Court specifically eliminated any need for proof of reliance and in the process, also eliminated proof of causation by making materiality (stated in general terms) a substitute for both reliance and causation on a class motion and later on trial. The substitute is permitted because market effect of a material misrepresentation will be presumed. The elimination of both is justified

because it is declared a 10b-5 case is not a fraud case, and these elements are irrelevant.[3]

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[3]At page 906:

"Defendants argue that proof of causation solely by proof of materiality is inconsistent with the requirement of the traditional fraud action. . . .

"We disagree. The 10b-5 action remains compensatory; it is not predicated solely on a showing of economic damage (loss causation). We merely recognize the individual 'transactional causation' can in these circumstances be inferred from the materiality of the misrepresentation, . . . and shift to defendant the burden of disproving a prima facie case of causation. Defendants may do so in at least 2 ways: 1) by disproving materiality or by proving that, despite materiality, an insufficient number of traders relied to inflate the price; and 2) by proving that an individual plaintiff purchased despite knowledge of the falsity of a representation, or that he would have, had he known of it.[21]

At page 907:

"That the prima facie case each class member must establish differs from the traditional fraud action, and may, unlike the fraud action, be established by common proof, is irrelevant; although derived from it, the 10b-5 action is not coterminous with a common law fraud action. As we recently recognized in *White v. Abrams,* the fraud action must be and has been flexibly adopted to the overriding purpose of enforcing the Federal securities laws.

"Here, we eliminate the requirement that plaintiffs prove reliance directly in this context because the requirement imposes an unreasonable and irrelevant evidentiary burden."

At page 908:

"Direct proof would inevitably be somewhat pro-forma, and impose a difficult evidentiary burden, because addressed to a speculative possibility in an area where motivations are complex and difficult to determine. That difficulty threatens to defeat valid claims—implicit in *Affiliated Ute* is a rejection of the burden because it leads to under-inclusive recoveries and thereby threatens the enforcement of the securities laws. *See,* Harv. Note, *supra,* at 590-91. Here, the requirement is redundant—the same causal nexus can be adequately established indirectly, by proof of materiality coupled with the common sense that a stock purchaser does not ordinarily seek to purchase a loss in the form of artificially inflated stock.[22] Under those circumstances we think it appropriate to eliminate the burden."

At page 908:

"Defendants contend that elimination of individual proof of subjective reliance alters and abridges their substantive

"Differences in sophistication, etc., among purchasers have no bearing in the impersonal market fraud contest, because *dissemination of false information necessarily translates through market mechanisms into price inflation* which harms each purchaser identically." (Page 905.) (Italics added.)

The decision also goes a step further in that it precludes a defendant from disproving causation because it is not an issue; only materiality is.[4] Also eliminated

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rights in violation of the Rules Enabling Act, 28 U.S.C. §2072. The obvious answer is that the standards of proof of causation we have set out apply to all fraud on the market cases, individual as well as class actions. No interpretation of Rule 23 is involved, and the Rules Enabling Act limitation is not implicated.[23]"

Again at page 906:

"Moreover, proof of subjective reliance on particular misrepresentations is unnecessary to establish a 10b-5 claim for a deception inflating the price of stock traded in open market. (Citing cases.) Proof of reliance is adduced to demonstrate the causal connection between the defendant's wrongdoing and the plaintiff's loss. We think causation is adequately established in the impersonal stock exchange context by proof of purchase and of the materiality of misrepresentations, without direct proof of reliance. Materiality circumstantially establishes the reliance of some market traders and hence the inflation in the stock price—when the purchase is made the causational chain between defendant's conduct and plaintiff's loss is sufficiently established to make out a prima facie case."

[4]*At Footnote 21* (page 906):

"A number of cases indicate that proof of materiality raises a 'presumption' of reliance. The Court did not speak of a presumption in *Mills* or *Affiliated Ute*; we prefer to recognize that materiality directly establishes causation more likely than not, and that reliance as a separate requirement is simply a milepost on the road to causation.

"There is some debate as to whether the 'presumption' of reliance may be rebutted; the general view is that it may be, *see* Harvard Note, *supra*, at 600 and 600 n. 75, and cases there cited, although sound contrary opinion exists. . . . We doubt the right to disprove causation will substantially reduce a defendant's liability in the open market fraud context, as we doubt that a defendant would be able to prove in many in-

is any concern of conflicts between plaintiffs, or apparently defendants; these can all be straightened out at trial, and rules changed to accommodate plaintiffs. (See pages 908, *et seq.*).

Finally, the Court indicates that it is prepared also to eliminate negligence or wrongdoing as an issue. The defendants' defense is confined to materiality. If a statement in a financial release is both wrong and material, liability accrues. This means absolute liability even for honest error.

We submit that these alterations of 10b-5 cases which remove all elements of reliance, causation and culpability, rendering it an action akin to absolute liability, are without authority. *Mitchell v. Texas Gulf Sulphur Co.,* 446 F.2d 90, 97 (10th Cir. 1971); *Republic Technology Fund, Inc. v. Lionel Corp.,* 483 F.2d 540 (2d Cir. 1973); *Cohen v. Franchard Corp.,* 478 F.2d 115 (2d Cir. 1973); *Clegg v. Conk,* 507 F.2d 1351 (10th Cir. 1974); and see recent cases collected in the Cumulative Supplement, January 1976 to Vol. No. 11A, Gadsby, *Business Organizations, The Federal Securities Exchange Act of 1934,* which show that while a 10b-5 case is not a common law fraud case, it is founded in fraud, the elements still affect the action, and causation is required.

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stances to a jury's satisfaction that a plaintiff was indifferent to a material fraud. Nevertheless, we think the public purpose can be adequately served within the traditional compensatory suit framework by limiting recoveries to those who are in fact injured, and excluding those whom a defendant proves have not been injured, and that 10b-5 suits should continue in that mold until a contrary need appears or until the Court directs otherwise."

We do not believe such changes in basic rights should be made in the guise of Rule 23 motion. Rule 23 is a matter of procedure and not a change of substantive rights, nor a weapon to enforce laws under the Enabling Act § 2072.

Nor do we believe III Loss, Securities Regulation 1819 (2d ed. 1961) ("the ultimate effectiveness of [the security anti-fraud laws] may depend on the applicability of the class action device"), means Rule 23 requires changes of substantive rights. In any event, Professor Loss' comment, published in 1961, is hardly authority for determining the needs of the market place in 1976. The Ninth Circuit seems to have fallen victim to the same lack of empirical support for sweeping conclusions for which it is so critical of the Second Circuit.

These substantive charges can be most graphically appreciated by examining their effect if applied to Touche Ross & Co. in the preparation and trial of this case. Touche Ross & Co. will be motivated, and should be entitled, to assert:

(i) that its duty to the plaintiffs stands on a different footing from that of the other defendants under the flexible duty standards set forth in *White v. Abrams,* 495 F.2d 724 (9th Cir. 1974);

(ii) that it has no single duty in common to all of the plaintiffs, but rather that its duty will be affected in part by the degree of knowledge and attention paid by the plaintiffs to the audited annual reports as opposed to market influences for which Touche Ross & Co. bore no responsibility;

(iii) that the market price of Ampex stock approximated its value during the periods between the issuance of audited annual reports and the subsequent publication of unaudited information with which Touche Ross & Co. was not associated;

(iv) in the alternative, that the degree of artificial inflation of Ampex security prices, if any, was less influenced by the audited annual reports than by other corporate announcements;

(v) that Touche Ross & Co. bears no responsibility for 43 of the 45 public statements by Ampex corporation which underly the plaintiffs' case;

(vi) that even if the co-defendants are chargeable with a common course of conduct, Touche Ross & Co. was not a party thereto and each plaintiff or relevant group of plaintiffs must demonstrate a causal nexus between errors, if any, by Touche Ross & Co. and such plaintiffs' decision to purchase.

The forms of discovery and proof necessarily related to the pursuit of these defenses are precisely the divergent and individualizing steps which the Ninth Circuit has directed the trial court to avoid in the interest of protecting the continuing viability of plaintiffs' class action. It is not sufficient to suggest that the potential for future delineation of subclasses resolves the problem, since (a) the Circuit Court has cut so deeply into substantive rights in order to preserve a common question and, (b) the District Court is clearly directed to avoid the recognition of subclasses numerous enough to threaten manageability.

The Court of Appeals clearly directs the District Court in the management of this case to focus on a single or few factual and legal issues affecting the legal liability of the defendants collectively to the plaintiffs collectively. This vision leaves insufficient flexibility for Touche Ross & Co. to individualize its role vis-a-vis the co-defendants and the various plaintiffs.

By first denying Touche Ross & Co.'s right to appeal under Section 1291 and then, under the Section 1292(b) appeal setting general guidelines for class actions in securities cases, in sweeping terms, the Ninth Circuit effectively has changed and narrowed the substantive rights of Touche Ross & Co. without having to deal expressly with the unfair burden created by these guidelines if applied to Touche Ross & Co. and other independent accounting firms that may well be similarly situated in other securities cases. Surely this kind of irreparable harm justifying an appeal under Section 1291 is required by *Cohen* and *Eisen*.

CONCLUSION

We submit that the Ninth Circuit has not merely chosen a position on the application of Rule 23 and the rights of appeal thereunder; it has taken the stance of an advocate promoting a new 10b-5 action of its own choosing.

The Ninth Circuit's decision in its basic premises and reasoning as well as its holding is in conflict with the recent decisions of this Court in *Blue Chip Stamps* and *Eisen IV*.

We urge this Court to grant certiorari to all defendants to ensure that future proceedings in this case and all similar cases will be consistent with the Court's views as expressed in *Cohen, Eisen IV* and *Blue Chip Stamps.*

Dated, March 12, 1976.

Respectfully submitted,
William W. Godward,
Michael Traynor,
Cooley, Godward, Castro,
Huddleson & Tatum,
Attorneys for Petitioner Touche Ross & Co.

Richard H. Murray,
Of Counsel.

(Appendices Follow)

APPENDICES

Appendix A

United States Court of Appeals for the Ninth Circuit

William Blackie, Robert E. Brooker, Richard J. Elkus, Arthur H. Hausman, Henry A. McMicking, Nathan W. Pearson, A. E. Ponting, Frederick Seitz, and Irving Trust Company, as Executor of the Estate of H. S. M. Burns, Deceased, Defendants-Appellants, vs. Leonard Barrack, Selma Molder and Pearl Singer, as Co-Executors of the Estate of Sylvia Barrack, Deceased, on behalf of herself and all others similarly situated, Plaintiffs-Appellees.	No. 74-2141
William E. Roberts and John Buchan, Defendants-Appellants, vs. Benjamin L. Kushner, et al., Plaintiffs-Appellees.	No. 74-2341
Ampex Corporation, Defendant-Appellant, vs. Benjamin L. Kushner, Plaintiff-Appellee.	No. 74-2167
Touche Ross & Co., Defendant-Appellant, vs. Leonard Barrack, Selma Molder and Pearl Singer, as Co-Executors of the Estate of Sylvia Barrack, Deceased, on behalf of herself and all others similarly situated, Plaintiffs-Appellees.	No. 74-2466

William E. Roberts, John P. Buchan, William Blackie, Robert E. Brooker, Richard J. Elkus, Arthur H. Hausman, Henry A. McMicking, Nathan W. Pearson, A. E. Ponting, Frederick Seitz, and Irving Trust Company, as Executor of the Estate of H. S. M. Burns, Deceased, Defendants-Appellants, vs. Leonard Barrack, Selma Molder and Pearl Singer, as Co-Executors of the Estate of Sylvia Barrack, Deceased, on behalf of herself and all others similarly situated, Plaintiffs-Appellees.	No. 74-2648

[September 25, 1975]

Appeal from the United States District Court for the Northern District of California

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OPINION

Before: TUTTLE,* KOELSCH and BROWNING, Circuit Judges.

KOELSCH, Circuit Judge:

These are appeals from an order conditionally certifying a class in consolidated actions for violation of Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10(b)-5.

The litigation is a product of the financial troubles of Ampex Corporation. The annual report issued May 2, 1970, for fiscal 1970, reported a profit of $12

*The Honorable Elbert P. Tuttle, United States Court of Appeals Senior Circuit Judge for the Fifth Circuit, sitting by designation.

million. By January 1972, the company was predicting an estimated $40 million loss for fiscal 1972 (ending April 30, 1972). Two months later the company disclosed the loss would be much larger, in the $80 to $90 million range; finally, in the annual report for fiscal 1972, filed August 3, 1972, the company reported a loss of $90 million, and the company's independent auditors withdrew certification of the 1971 financial statements, and declined to certify those for 1972, because of doubts that the loss reported for 1972 was in fact suffered in that year.

Several suits were filed following the 1972 disclosure of Ampex's losses. They were consolidated for pre-trial purposes. The named plaintiffs in the various complaints involved in these appeals[1] purchased Ampex securities during the 27 month period between the release of the 1970 and 1972 annual reports, and seek to represent all purchasers of Ampex securities during the period. The corporation, its principal officers during the period,[2] and the company's independent auditor are named as defendants. The gravamen of all the claims is the misrepresentation by reason of annual and interim reports, press releases and SEC filings of the financial condition of Ampex from the date of the 1970 report until the true con-

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[1]The lead action here, the so-called *Molder* action, was originally filed in the Eastern District of Pennsylvania in January of 1972, and transferred to the Northern District of California, where it was consolidated for pretrial with seven other actions. Twelve parties have been allowed to intervene as plaintiffs in the *Molder* action.

[2]Appellants Roberts and Buchan terminated their relationship with Ampex during the class period; the remaining individual defendants were in office throughout the period.

dition was disclosed by the announcement of losses in August of 1972.

The plaintiff's moved for class certification shortly after filing their complaints in 1972; after extensive briefing and argument the district judge entered an order on April 11, 1974, conditionally certifying as a class all those who purchased Ampex securities during the 27 month period. The defendants filed notices of appeal from the order of certification on May 9 and 10, 1974.[3]

Additionally, the district judge, in an order entered July 1, 1974, denying a motion made by defendants Roberts and Buchan, and defendants Blackie, *et al.*, for reconsideration of the class certification, permitted those defendants to seek an interlocutory appeal from that order under 28 U.S.C. § 1292(b).[4] We granted the petition for interlocutory review.[5] That appeal was designated No. 74-2648, and consolidated with the direct appeals.

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[3]The direct appeals are designated Nos. 74-2141, 74-2341, 74-2167, and 74-2466.

[4]The district court did not grant permission to appellants Touche and Ampex to seek interlocutory review, as they had not joined in the motion for reconsideration filed before the filing of their notices of appeal. The court assumed that the filing of the notices divested him of jurisdiction over those defendants. We reject Ampex's argument that it is here under § 1292(b) by virtue of its codefendant's interlocutory appeal and its own filing of a notice of appeal under Fed. R. App. P. 4. The taking of an interlocutory appeal requires a discretionary judgment by both the district court and court of appeals—that judgment is exercised with respect to particular parties. As a result, Fed. R. App. P. 5 does not provide, as does Rule 4, for parties to join in others' appeals.

[5]Thus, whether the standards for certification of such an appeal set out in § 1292(b) were met has been decided, and is not now before us.

In December of 1974, plaintiffs filed a motion to dismiss the various appeals—the purportedly direct appeals on the ground that the certification order is not appealable under 28 U.S.C. § 1291, and the § 1292(b) appeal on the ground that it has been prosecuted in a dilatory manner.

The appeals having now been heard and submitted, we face three issues: 1) whether the order certifying the class is a final order appealable under § 1291; 2) whether the interlocutory appeal should be dismissed; and (if any of the appeals are properly before us) 3) whether the district court order certifying the class was proper under the standards set out in Fed. R. Civ. P. 23(a) and (b)(3). To summarize our decision, we hold the certification order non-appealable and dismiss the direct appeals; we deny the motion to dismiss the § 1292(b) certified appeals; and, on the merits, hold that the suit may properly be maintained as a class action.

I. *Appealability under § 1291 of an order granting class action status.*

The courts of appeals have jurisdiction over appeals of right under 28 U.S.C. § 1291 only from "final decisions" of the district courts. The statutory limitation is the product of a two-fold policy judgment about judicial administration which was written into the first Judiciary Act and adhered to ever since. *See Cobbledick v. United States,* 309 U.S. 323, 324-325 (1940). The requirement saves judicial time by eliminating review of rulings adverse to an eventually

successful litigant. But more importantly, the uniform imposition of finality as a condition of review improves the quality of justice administered by the judicial system. On balance, the rule shortens the time needed for resolution of controversies, saving litigants both time and money; "[requiring finality avoids] the obstruction to just claims that would come from permitting the harassment and cost of a succession of separate appeals from the various rulings to which a litigation may give rise, from its initiation to entry of judgment." *Cobbledick, supra,* at 325. In short, the rule is one of the primary bars against Bleak House Judicial administration;[6] as such, its rationale applies equally to an order certifying a class.

Nevertheless, in some circumstances deferring an appeal practically operates to deny effective review, as the right threatened by an adverse ruling will have been lost in the interim before final disposition of the other aspects of the controversy. The Court therefore has given the § 1291 final decision requirement a "practical rather than a technical construction," *Cohen v. Beneficial Industrial Loan Corp.,* 337 U.S.

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[6]A system of judicial administration, fortunately unknown in this country,

> "which has its ruined suitor, with his slipshod heals and threadbare dress, borrowing and begging through the round of every man's acquaintance; which gives to monied might, the means abundantly of wearying out the right; which so exhausts finances, patience, courage, hope; so overthrows the brain and breaks the heart; that there is not an honorable man among its practitioners who would not give—who does not often give—the warning, 'Suffer any wrong that can be done you, rather than come here!' "

Dickens, Bleak House, quoted in The World of Law—I, The Law *in* Literature 42 (E. London ed. 1960).

341, 348 (1949), and allowed interlocutory appeal from a "small class [of orders] which finally determine claims of right separable from, and collateral to, rights asserted in the action, too important to be denied review and too independent of the cause itself to require that appellate consideration be deferred until the whole case is adjudicated." *Cohen,* at 546. *See Eisen v. Carlisle & Jacquelin,* 417 U.S. 156, 170-172 (1974) (*Eisen IV*); *Note, Class Action Certification Orders: An Argument for the Defendant's Right to Appeal,* 42 Geo. Wash. L. Rev. 621, 625-628 (1974). Two of the three circuits which have faced the issue have nevertheless held a class certification order non-appealable under *Cohen. Thill Securities Corp. v. New York Stock Exchange,* 469 F.2d 14 (7th Cir. 1972); *Walsh v. City of Detroit,* 412 F.2d 226 (6th Cir. 1969). *Accord,* 9 J. Moore, Federal Practice ¶ 110.13[9], at 184-187 (2d ed. 1970).

The Second Circuit, however, has permitted appeal in certain limited circumstances. In *Eisen v. Carlisle & Jacquelin,* 370 F.2d 119 (2d Cir. 1966), *cert. denied,* 386 U.S. 1035 (1967) (*Eisen I*), that court recognized that an order denying class action status effectively sounded the "death knell" of the plaintiff's suit. As "no lawyer of competence is going to undertake this complex and costly case to recover $70 for Mr. Eisen," the individual claim could not be adjudicated, and as a practical matter the class question could never be appealed. The court therefore concluded the order was appealable under *Cohen.* We have adopted the death knell doctrine. *Falk v. Dempsey-Tegeler & Co., Inc.,*

472 F.2d 142 (9th Cir. 1972); *Weingartner v. Union Oil Company of California,* 431 F.2d 26 (9th Cir. 1970).

From that springboard the Second Circuit developed a "reverse death knell" doctrine with respect to a defendant and his rights to foreclose an ostensible class suit against him. Influenced by the suggestion that it consider a rule which would "afford equality of treatment as between plaintiffs and defendants" (*Korn v. Franchard Corp.,* 443 F.2d 1301, 1307 (2d Cir. 1971) (Friendly J., concurring)), a panel of the circuit held in *Eisen v. Carlisle & Jacquelin,* 479 F.2d 1005, 1007 n.1 (2d Cir. 1973) (*Eisen III*), that defendants could appeal an order granting class status under three specified conditions. As explicated in *Herbst v. International Telephone and Telegraph Corp.,* 495 F.2d 1308, 1312 (2d Cir. 1974), such an order is appealable when the class determination is "'fundamental to the further conduct of the case'" (*i.e.,* when, were the class determination reversed, the individual claims presented would be too small to continue the suit, thus effectively terminating it—the reverse death knell situation);[7] when the *order* is "'separable from the merits;'" and when it will result in "'irreparable harm to the defendant in terms of time and money spent in defending a huge class action.'" *Herbst,* at 1312, quoting from *Eisen III,* at

[7]*See General Motors Corp. v. City of New York,* 501 F.2d 639, 645 (2d Cir. 1974); *Kohn v. Royall, Koegal and Wells,* 496 F.2d 1094, 1099 (2d Cir. 1974). *But see General Motors Corp., supra,* at 656-657.

1007 n.1. We are asked, the issue being novel in this circuit, to adopt the Second Circuit's position.[8]

We decline to do so, because we believe that the Second Circuit's rule impermissibly[9] disregards the conditions placed on appealability by *Cohen*. The rule of finality is a statutorily imposed restraint on our jurisdiction; as noted, it imposes a legislative judgment that on balance time and money will be saved if appeal is deferred until the conclusion of a suit. We are not free to disregard that judgment; exceptions to uniform application undermine the rule's purpose by fostering litigation about whether an order is exceptional and appealable. And with the proliferation of narrow and peculiar exceptions, the

[8]Wholly aside from our disagreement with the Second Circuit rule, we doubt that the order involved here would be appealable under that rule. Including intervenors, the named plaintiffs purchased 10,000 shares during the class period and damages would appear to be such that the action would proceed were the order reversed. Thus, criteria 1 may not be satisfied. *See, e.g., Falk, supra,* (holding individual claim of $14,125 too large to invoke death knell doctrine); *Shayne v. Madison Square Garden Corp.*, 491 F.2d 397 (2d Cir. 1974); (individual claim of $7,482 too large); *Milberg v. Western Pacific R.R.*, 443 F.2d 1301 (2d Cir. 1971) ($8,500 claim too large). Moreover, in this case the second criteria is probably not met either. *See Kohn, supra,* at 1099; *General Motors Corp., supra,* at 646, 659.

[9]We recognize that it is not altogether certain that the *Cohen* standards represent the outer parameters of appealability, in light of the Court's admonition in that case to give the final decision rule a practical rather than technical construction, and its later observation in *Eisen IV*, at 170, that "[n]o verbal formula yet devised can explain prior finality decisions with unerring accuracy or provide an utterly reliable guide for the future." However, we think those standards were so intended and should be so read, for the same reasons that we think the *Cohen* exception was intended to be narrowly construed, which we set out below.

more doubtful and difficult it becomes to determine appealability, at district and appellate court levels, increasingly inviting supposedly foreclosed interlocutory litigation.

In this view, and while recognizing that it is nevertheless such an exception, we think the *Cohen* "collateral order" standards should be restrictively construed. The *Cohen* rule is an effort to prevent the inevitable injustices to litigants which result from application of a prophylactic rule which operates "on balance," but only in those limited situations where it can be accomplished with a minimum intrusion on the statutory policy. Thus, *Cohen* requires not only that denial of immediate review result in loss of a right which cannot be sustained by later review, but also that the order appealed from be final and collateral. Thus, even when an injustice may result, immediate review is available only when the appellate court will not be required to duplicate efforts entailed in a later review on the merits, or to review a decision whose tentative nature will render the appellate court's decision fruitless later in the lawsuit.

We are clear that a class certification order does not fall within *Cohen*. The finality condition is not met, as such an order is not a final determination of the propriety of a class. Under Fed. R. Civ. P. 23(c)(1), a class must be certified as soon as practicable after commencement of the action, and is made conditional and subject to alteration, to the creation of sub-classes, Rule 23(c)(4)(B), or indeed to decertification as the suit progresses and newly discov-

ered facts warrant.[10] Nor is the class issue separable from the merits in all cases (including this one). The common questions, typicality, conflicts and adequacy of representation, Fed. R. Civ. P. 23(a), and predominance tests, Fed. R. Civ. P. 23(b) (3), are determinations (unlike, for example, the notice question involved in *Eisen IV*) which may require review of the same facts and the same law presented by review of the merits.[11]

Nor, for that matter, does the order threaten the defendant with any irreparable harm cognizable under *Cohen*. The defendant does not lose any legal rights or entitlement in the interim between certification and appeal—appeal after the litigation fully protects from a judgment for an improper class. *See* Geo. Wash. Note, *supra,* at 628-630.

The Second Circuit found the requisite injury in the increased, and generally irrecoverable, costs of defending the class action. With deference, we disagree. The final decision rule itself often increases the time and cost of litigation. Denial of immediate review from orders denying motions to dismiss, Fed. R. Civ. P. 12(b)(6), or for summary judgment, Fed.

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[10]"But we do not mean that every order fixing security is subject to appeal. Here it is the right to security that presents a serious and unsettled question. If the right were admitted or clear and the order involved only an exercise of discretion as to the amount of security, a matter the statute makes subject to reconsideration from time to time, appealability would present a different question." *Cohen,* at 547.

[11]*See Kohn, supra,* at 1099; *General Motors Corp., supra,* at 659. In fact, as a ruling on class certification must be made soon after commencement of the action, the facts governing the class determination will inevitably be less clear than after the case has gone to judgment.

R. Civ. P. 56, may subject a defendant in particular cases to defense costs equivalent to those incurred in defending a class action. Geo. Wash. Note, *supra*, at 629-630; *Kohn v. Royall, Koegel & Wells*, 496 F.2d 1094, 1098-1099 (2d Cir. 1974). Such litigants must bear those costs because of the legislative judgment that a final decision rule will most benefit all litigants, statutorily foreclosing reliance on litigation costs as a justification for departure from the final decision rule.[12]

It strikes us that the Second Circuit rule is the product of three policy considerations, urged on us here as well, which we conclude are insufficient to justify departure from the *Cohen* gloss on the rule.

The first is that litigation costs will be reduced by allowing appeal and thus avoiding the substantial costs of litigating an improperly certified class. While perhaps true in a particular suit, we suspect that the savings envisioned may well prove illusory. Applied to all class actions, the Second Circuit's rule saves time and money only when the appellate court determines the particular class certification order is appealable, when the order would not have been otherwise appealable under the narrower *Cohen* exception, when the district judge would have refused to certify a § 1292(b) appeal, where the district judge would not later decertify the class, and where, on the merits,

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[12]Neither *Cohen* nor *Eisen IV* support the Second Circuit in this regard. In both cases the defendant was threatened with costs which the applicable statute placed on the plaintiff. In neither case did the Court rely on general litigation expense to justify appealability.

the order is reversed. Even then, later developments in the suit may lead to reinstatement of the class. To be balanced against savings is the loss of time and money resulting from appeal in which the order is held non-appealable, or the order is affirmed. Neither we nor (we suggest) the Second Circuit have any way of striking that balance. We can only speculate concerning the various costs, time spans, and percentages which must necessarily be appraised to determine whether the Second Circuit's exception could pay its way; it is ultimately a question which is best suited to legislative investigation and judgment.

Moreover, we would suggest that the number of suits in which a rule of appealability would be worthwhile may be relatively small. The standard of review is abuse of discretion. A number of the criteria set out in Rule 23 relate to matters, such as manageability, adequacy of representation, feasibility of joinder, superiority to other available methods of adjudication, and the like, which are much more within the knowledge of the district court in touch with the litigation than in ours; our review is unlikely to add any superior wisdom, or to reverse on those grounds. In those cases which turn on a question of law, the district judge may certify an interlocutory appeal.[12a] The number of cases in which massive litigation costs are threatened, in which a district judge declines to

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[12a] Generally an order granting class action status does not involve a controlling question of law when entered because it has no significant effect on the litigation until issues not pertaining to the personal claims of the class representative have to be decided. Note, *Interlocutory Appeals in the Federal Courts Under 28 U.S.C. § 1292(b)*, 88 Harv. L. Rev. 607, 630-631 n.97 (1975).

certify an appeal, and which thereafter results in reversal of the class certification, may prove small indeed.

The second consideration is that, because the "death knell" doctrine allows plaintiffs to appeal orders denying class status, parity of treatment requires that defendants be allowed to appeal orders granting such status. We disagree. Precisely the same disparity exists between plaintiffs and defendants with regard to summary judgment or motion to dismiss orders. So long as they are differently situated in a manner relevant to the purposes of the final decision rule, plaintiffs and defendants may be treated differently. Suffice it here to say that they are differently situated with respect to the finality of the class order—an order denying in the "death knell" situation effectively terminates the suit and precludes presentation of the merits; an order granting does not end the suit, or preclude presentation of the defense, and is subject to reevaluation as well. *See* Geo. Wash. Note, *supra,* at 631-632.

The final consideration relied on by the Second Circuit, *see Herbst, supra,* at 1313, strenuously urged here, is that a class certification order in a large-class, small-claim class action threatens such ruinous liability that the defendant inevitably must settle even frivolous claims, thereby effectively precluding review of the crucial class certification order unless interlocutory review is allowed. Again, we are unpersuaded. In large part the argument is an attack on the decision reflected in Rule 23 to allow integration of

numerous small individual claims into a single powerful unit, rather than to an attack peculiarly germane to the operation of the final decision rule in the class action context. Precisely the same power to coerce a settlement (and defeat review of potentially erroneous previous orders) is wielded by any plaintiff with a substantial claim—that fact alone does not generally confer appealability on an order which effectively requires a defense to a large claim. The fairness of the pressure—*i.e.*, the sociological merits of the small claims class action—is not a question for us to decide. The fact is that Congress, by authorizing and approving Rule 23(b)(3), created a vehicle to put small claimants in an economically feasible litigating posture. In that light, we doubt the propriety of an attendant judicial alteration of the final decision rule which immediately (and uniquely) subjects redress of class plaintiffs' claims to the delay and cost of an appeal.

We recognize, of course, that it is the class certification order itself which, if erroneous, creates the improper coercive effect. That is a distinction without a difference unless class certification orders have unique effects specially implicating the policy of the final decision rule. It may well be that a higher percentage of class certification orders are erroneous than others which subject a defendant to the coercion of a large potential liability; or that a higher percentage of frivolous claims are presented in class actions than in others; or that the magnitude of the potential liability in class actions is leading to settle-

ment of more frivolous claims and abandonment of more meritorious appeals, than occurs in other litigation. If such is not the case, there is no reason to treat a class certification order differently than any other interlocutory order. If so, an exception may or may not be justified.[13]

In either event, however, the argument is again properly addressed to Congress. We have no reliable knowledge,[14] and no good means of acquiring any, about the present nature and number of class action settlements, and of how that experience compares with individual lawsuits of the same type, or pressing claims of similar magnitude. Thus, we have no means of deciding whether the present hue and cry of "blackmail" in fact reflects an abnormally high in-

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[13]We note that the supposed *in terrorem* effect of the class certification will persist despite a right of immediate appeal—the claim may be frivolous and the class proper. Immediate appeal will eliminate only the improperly certified coercive class action, at the expense of both frivolous and non-frivolous, property certified classes. It may well be better to attack the "blackmail" problem directly with appropriate safeguards rather than collaterally undermining the final decision rule.

[14]Both sides have cited extensive commentary, by courts and critics alike, on the supposed *in terrorem* effect of class actions. Almost inevitably those opinions are supported by highly inconclusive, or no, empirical evidence; most of the debate is founded on speculation, primarily dictated by the writer's personal experience and feelings for or against class actions. The empirical evidence on the subject is very limited, and not particularly helpful because it provides no basis for comparison of class actions with other suits. For what it is worth, however, the empirical evidence indicates that a relatively high proportion of class actions are not settled, but disposed of in defendant's favor on preliminary motions. *See* Committee on Commerce, United States Senate, *Class Action Study*, 93d Cong., 2d Sess. (1974), Committee Print at 9-10. On the basis of the evidence before it, the Commerce Committee concluded that the class action was not a particularly effective vehicle for coercing settlements.

cidence of unfairly coerced settlements, or is rather the pained outcry of defendants whose previously advantaged litigating position has been undermined, and who must now confront small claimants (who have been given the capacity to exert pressure proportionate to the magnitude of the total injury occasioned by defendant's alleged violation of the law) on more equal grounds. Without such knowledge, there is no justification for departure from the "final decision" rule in this context, and we decline to do so.

Consequently, the § 1291 appeals designated Nos. 74-2141, 74-2167, 74-2341 and 74-2466 are dismissed.

II. *The § 1292(b) interlocutory appeals.*

We deny the motion to dismiss the § 1292(b) appeals.

The prosecution of these appeals has not been a model of diligence. Defendants were granted an extension of the time to transmit the record, and three extensions in the briefing schedule. Some of those delays could have been avoided; while the issues involved are somewhat complex, we note that much of the material in the appellate briefs was presented to the trial court, and that the lawyers did not start from scratch here.

However, the motion to dismiss is addressed to our discretion, and we think dismissal is not mandated in this case. From the somewhat conflicting representations before us it appears that appellees may have agreed to the extensions, although that acquiescence may have been induced by a now disclaimed repre-

sentation that plaintiffs could continue with discovery while the case was on appeal. Because the record is hazy, because we have granted the extensions, and because the issues have now been briefed and argued and are ripe for decision, we think the preferable course is for us to decide the appeal and provide guidance to the trial court. However, we do note that one purpose of interlocutory appeals is to hasten the conclusion of a lawsuit, that briefing extensions defeat that purpose, and that in appropriate circumstances we can deny unwarranted extensions and dismiss appeals to prevent an interlocutory appeal from being misused as a dilatory tactic.

We turn to the merits of defendants' Buchan and Roberts, and Blackie, et al., § 1292(b) appeals.

III. *Compliance with the Requirements of Fed. R. Civ. P. 23(a) and (b) (3).*

A. *The court's approach to class certification*

As a preliminary matter, we face the contention that the district judge certified the class in an inappropriate manner. Relying on our opinion in *In re Hotel Telephone Charges*, 500 F.2d 86, 90 (9th Cir. 1974) defendants argue that he improperly engaged in speculation when determining whether a common question exists, and whether conflicts make class representation inadequate, rather than determining, before certifying the class, that the requirements of the Rule were in fact met. We disagree.

From a thorough review of the district judge's opinion, we think it apparent that he analyzed the allega-

tions of the complaint[15] and the other material before him (material sufficient to form a reasonable judgment on each requirement), considered the nature and range of proof necessary to establish those allegations, determined as best he was able the future course of the litigation, and then determined that the requirements were met at that time.[16] That is all that is required.

Defendants misconceive the showing required to establish a class under *Hotel Telephone Charges.* We indicated there that the judge may not conditionally certify an improper class on the basis of a speculative possibility that it may later meet the requirements. 500 F.2d at 90. However, neither the possibility that a plaintiff will be unable to prove his allegations, nor the possibility that the later course of the suit might unforeseeably prove the original decision to certify the class wrong, is a basis for declining to certify a class

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[15]In large part appellants' attack on the district judge's approach is a reiteration of their disagreement with his legal conclusions. The speculative language seized upon in the opinion simply conditions the conclusion that a common question exists on plaintiffs' proof of the allegations—*i. e.,* if plaintiffs prove their allegation of X, X will be a question of fact or law common to the class. Such speculation is entirely proper and necessary. Likewise, the court ruled that any conflicts at present did not appear to defeat adequacy of representation, but that if any unforeseen difficulties arose, they could be cured by sub-classes—again a proper application of the Rule.

[16]The court is bound to take the substantive allegations of the complaint as true, thus necessarily making the class order speculative in the sense that the plaintiff may be altogether unable to prove his allegations. While the court may not put the plaintiff to preliminary proof of his claim, it does require sufficient information to form a reasonable judgment. Lacking that, the court may request the parties to supplement the pleadings with sufficient material to allow an informed judgment on each of the Rule's requirements.

which apparently satisfies the Rule. The district judge is required by Fed. R. Civ. P. 23 (c)(1) to determine "as soon as practicable after the commencement of an action brought as a class action . . . whether it is to be so maintained." The Court made clear in *Eisen IV* that that determination does not permit or require a preliminary inquiry into the merits, 417 U.S. at 177-178; thus, the district judge is necessarily bound to some degree of speculation by the uncertain state of the record on which he must rule. An extensive evidentiary showing of the sort requested by defendants is not required. So long as he has sufficient material before him to determine the nature of the allegations, and rule on compliance with the Rule's requirements, and he bases his ruling on that material, his approach cannot be faulted because plaintiff's proof may fail at trial. Of course, whether he applied correct legal principles in making the ruling, and whether the ruling was within the permissible boundaries of the discretion vested in him, is another question, to which we now turn.

B. *The merits of class certification.*

Defendants question this suit's compliance with each of the various requirements of Rule 23(a) and (b)(3)[17] except numerosity (understandably, as it ap-

[17]Rule 23 provides in part:

"(a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties

pears that the class period of 27 months will encompass the purchasers involved in about 120,000 transactions involving some 21,000,000 shares). However, all of defendants' contentions can be resolved by addressing 3 underlying questions: 1) whether a common question of law or fact unites the class; 2) whether direct individual proof of subjective reliance by each class member is necessary to establish 10b-5 liability in this situation; and 3) whether proof of liability or damages will create conflicts among class members and with named plaintiffs sufficient to make representation inadequate? We turn to the first issue.

1. *Common questions of law or fact.*

The class certified runs from the date Ampex issued its 1970 annual report until the company released its 1972 report 27 months later. Plaintiffs' complaint alleges that the price of the company's stock was artificially inflated because:

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will fairly and adequately protect the interests of the class.

"(b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

* * * *

"(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action."

"the annual reports of Ampex for fiscal 1970 and 1971, various interim reports, press releases and other documents (a) overstated earnings, (b) overstated the value of inventories and other assets, (c) buried expense items and other costs incurred for research and development in inventory, (d) misrepresented the companies' current ratio, (e) failed to establish adequate reserves for receivables, (f) failed to write off certain assets, (g) failed to account for the proposed discontinuation of certain product lines, (h) misrepresented Ampex's prospects for future earnings."

The plaintiffs estimate that there are some 45 documents issued during the period containing the financial reporting complained of, including two annual reports, six quarterly reports, and various press releases and SEC filings.

Because the alleged misrepresentations are contained in a number of different documents, each pertaining to a different period of Ampex's operation, the defendants argue that purchasers throughout the class period do not present common issues of law or fact. They reason that proof of 10b-5 liability will require inspection of the underlying set of facts to determine the falsity of the impression given by any particular accounting item presented; that the underlying facts fluctuate as the business operates *(i.e.,* inventory is bought and sold, accounts are paid off and created); thus, proof of the actionability of a current accounting representation or omission will apply only to those who purchased while a financial report was current; from which they conclude no common question is presented and a class is improper.

We disagree. The overwhelming weight of authority holds that repeated misrepresentations of the sort alleged here satisfy the "common question" requirement. Confronted with a class of purchasers allegedly defrauded over a period of time by similar misrepresentations, courts have taken the common sense approach that the class is united by a common interest in determining whether a defendant's course of conduct is in its broad outlines actionable, which is not defeated by slight differences in class members' positions, and that the issue may profitably be tried in one suit. *See Green v. Wolf Corporation,* 460 F.2d 291, 298 (2d Cir. 1968); *Esplin v. Hirschi,* 402 F.2d 94 (10th Cir. 1968); *Harris v. Palm Springs Alpine Estates,* 329 F.2d 909 (9th Cir. 1964); *U.S. Financial Securities Litigation,* 64 F.R.D. 443 (S.D. Cal. 1974); *Aboudi v. Daroff,* 65 F.R.D. 388 (S.D.N.Y. 1974); *Werfel v. Kramarsky,* 61 F.R.D. 674 (S.D.N.Y. 1974); *In re Memorex Security Cases,* 61 F.R.D. 88 (N.D. Cal. 1973); *Siegel v. Realty Equities Corporation of New York,* 54 F.R.D. 420 (S.D.N.Y. 1972); *Herbst v. Able,* 47 F.R.D. 11 (S.D.N.Y. 1969); *Dolgow v. Anderson,* 43 F.R.D. 472 (E.D.N.Y. 1968); *Siegel v. Chicken Delight, Inc.,* 271 F. Supp. 722 (N.D. Cal. 1967); *Fischer v. Kletz,* 41 F.R.D. 377, 381 (S.D.N.Y. 1966); *Kronenberg v. Hotel Governor Clinton, Inc.,* 41 F.R.D. 42 (S.D.N.Y. 1966). As we stated in *Harris, supra:*

> "Appellees assert that the various investors made payments on the securities at different times and stand in different positions . . . [S]ince the complaint alleges a common course of conduct over the entire period, directed against all inves-

tors, generally relied upon, and violating common statutory provisions, it sufficiently appears that the questions common to all investors will be relatively substantial." 329 F.2d at 914.

Those views are consistent with the views of the Advisory Committee on the Rule: "[A] fraud perpetrated on numerous persons by the use of similar misrepresentations may be an appealing situation for a class action . . ." Advisory Committee on Rule 23, Proposed Amendments to the Rules of Civil Procedure, 39 F.R.D. 69, 103 (1966). The availability of the class action to redress such frauds has been consistently upheld, *see In re Caesars Palace Securities Litigation,* 360 F. Supp. 366, 395-96 (S.D.N.Y. 1973), in large part because of the substantial role that the deterrent effect of class actions plays in accomplishing the objectives of the securities laws. *See* III Loss, Securities Regulation 1819 (2d ed. 1961) ("the ultimate effectiveness of [the security antifraud laws] may depend on the applicability of the class action device").

While the nature of the interrelationship and the degree of similarity which must obtain between different representations in order to come within the outer boundaries of the "common course of conduct" test is somewhat unclear,[18] the test is more than satisfied

[18]Because plaintiffs have alleged specific strands of misrepresentation running throughout financial statements of the class period, they are well within whatever the outer boundaries might be, and we need not resolve the issue. We note, however, that a number of courts have apparently held that allegations simply that earnings and stock price have been inflated over a period of time by a defendant's misrepresentations is sufficient to satisfy the common question requirement (although the cases are somewhat unclear because they fail to specify the precise misrepresentations

when a series of financial reports uniformly misrepresent a particular item in the financial statement. In

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which allegedly inflated earnings). *See Fischer v. Kletz, supra; Kronenberg, supra; Werfel v. Kramarsky, supra. See Feldman v. Lifton*, 64 F.R.D. 539, at 544-545 (S.D. N.Y. 1974). Appellants point out that allegation of inflation of earnings or price is conclusionary, and may derive from altogether unrelated misrepresentations. In their view the common question requirement is met only if all purchasers are injured by the same misrepresentation, or, in a "course of conduct" case, by identical repeated misrepresentations, and if defendant's liability can be established by proof both of the same set of facts and same legal principle. We think that is far too restrictive a view of the common question requirement in the securities fraud context. Rule 10b-5 liability is not restricted solely to isolated misrepresentations or omissions; it may also be predicated on a "practice, or course of business which operates . . . as a fraud . . ." Under that section class members may well be united in establishing liability for fraudulently creating an illusion of prosperity and false expectations.

Moreover, even when misrepresentations are unrelated, class members may share a common question of law or fact. Of course, if an early misrepresentation is undissipated, a later purchaser will present a common question even if another misrepresentation has intervened. But even if the effect of the earlier misrepresentation is dissipated, proof of the earlier misrepresentation may be relevant to the latter purchaser's case. Proof of the earlier fraud and its effects might be relevant circumstantially to establish duty standards, culpability, or damages regarding the later fraud; it would establish background information about the defendant common to both suits. Thus, even when unrelated misrepresentations are alleged as part of a common scheme, class members may share common factual questions, and trial in the same form avoids duplicative proof. That is a major purpose of a class action; the "common question" requirement should be interpreted to obtain that objective. Naturally, when the component misrepresentations of a "course of conduct" fraud are unrelated, a great many more non-common questions exist. In that situation no representative's claim may be typical of the rest of the class, Rule 23(a)(3), although that depends on how broadly that requirement is construed. *See* text at note 25, *infra,* and note 25 *infra.* We think it is for the predominance and other requirements of Rule 23(b)(3), rather than the common question requirement, to function to keep the balance between the economies attained and lost by allowing a class action. The common question requirement should not be restrictively interpreted to attain that objective, particularly as to do so would eliminate the class action deterrent for those who engage in complicated and imaginative rather than straightforward schemes to inflate stock prices.

that situation, the misrepresentations are "interrelated, interdependent, and cumulative;" "[l]ike standing dominoes . . . one misrepresentation . . . cause[s] subsequent statements to fall into inaccuracy and distortion when considered by themselves or compared with previous misstatements." *Fischer v. Kletz, supra,* at 381.

Precisely such a situation is alleged here in at least three respects—the failure to create adequate reserves for uncollectible accounts receivable and for contractually guaranteed royalty payments, and the overstatement of inventory. The 1972 Annual Report shows writedowns of $31.9 million as provision for royalty guarantees, $11.8 million for uncollectible accounts receivable, and $15 million for inventory. Plaintiffs allege that the writedowns had roots tracing back to the beginning of the class period, an allegation somewhat borne out by the auditors' withdrawal of certification of the 1971 report because of uncertainty that the huge losses reported in 1972 were the product of 1972 business operations, and not attributable to earlier years. Plaintiffs contend that the company's financial reports throughout the period uniformly and fraudulently failed to establish reserves in amounts adequate to satisfy accepted accounting principles, injuring all purchasers of the consequently inflated stock.

In this aspect, plaintiffs allege a source of inflation common to every purchaser. The creation of a reserve is of course simply an adjustment made to the balance sheet and income statement to provide a more realis-

tic view of the business and its operations. Failure in any particular period to recognize that a portion of the accounts receivable generated in that period are uncollectible, and to create or adjust a reserve, will have the effect of inflating the balance sheet assets and surplus, and overstating the income for the period; likewise failure to recognize accrued liabilities for royalty payments will inflate surplus by understating liabilities, and will overstate income. Naturally, any inflation in the stock price due to inadequate reserves will persist until the reserves become adequate or until the losses are in fact written off.

Defendants nevertheless contend that a class is improper because each purchaser must depend on proof of a different set of accounting facts to establish the inadequacy of the reserves at the time he bought. Defendants misconceive the requirement for a class action; all that is required is a common issue of law *or* fact. Even were we to assume that the reserves were at some points during the period adequate, the class members still would be united by a common interest in the application to their unique situation of the accounting and legal principles requiring adequate reserves—*i.e.*, by a common question of law.[19] Here,

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[19]Appellants make much of the distinction between an accounting principle and estimate, arguing that the exercise of judgment involved in an estimate depends on analysis of facts which change, making legal evaluation of different estimates distinct legal and factual problems. The distinction makes little sense in this context. The judgment necessary to make an estimate must be controlled by the accounting principle. Thus, even when only detached, unconnected incidents of incorrect estimates are alleged, the jury must nevertheless be appraised of the common standard of law by which to judge the estimates—the accounting principle—and

however, in light of the progressive deterioration of Ampex's financial position and the magnitude of the losses at the end of the period, even the fact that reserves were in reality inadequate throughout much if not all of the period may not be in serious dispute; rather, the question will be whether the inadequacy was in some sense culpable because the contingencies which proved them inadequate were foreseen or forseeable.

The alleged inventory overvaluation likewise presents common issues. Defendants again contend it does not because the valuation of any particular period's closing inventory involves a process of physical estimation based on that inventory's characteristics, and that overstatement of one period's closing inventory, while overstating that period's income, will have an opposite effect on the next period's income by overstating opening inventory, deflating rather than inflating stock price. While true in the abstract, appellants' position disregards the real substance of the plaintiffs' complaint which is again highlighted by the 1972 Report. In explaining the $15 million writedown, the company stated: "Inventories of stereo tapes more than six months old and more than one year old were written down 50% and 100% respectively . . . No significant writedowns of this nature were made in the prior year."

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a common question is presented. Insofar as a class action is involved, the situation is the same as where a consistent misapplication of an accounting principle as part of a course of conduct to inflate the stock price is alleged. And, moreover, it appears to us, contrary to appellants' contentions, that plaintiffs are complaining of abuses of accounting principles, not estimates.

Plaintiffs thus are complaining of the balance sheet effect of inventory overvaluation. They are alleging that by failing throughout the class period to recognize and account for inventory obsolescence each time the inventory was valued, the company consistently inflated the value at which it carried inventory on the balance sheet.[20] In effect, plaintiffs are complaining of a consistent disregard of the accounting principle that inventory be valued at "lower of cost or market." Again, common question of law and facts are presented.

The class members also share an interest in establishing the standard of care required of the various defendants under the *White v. Abrams,* 495 F.2d 724 (9th Cir. 1974), flexible duty standard. The flexible duty of any defendant, while depending on his particular relationship to Ampex and to the financial reporting involved, will be owed identically to all market purchasers, who are for practical purposes identically situated. The culpability of each defendant's conduct is to be measured against the statutorily imposed duty not to manipulate the market. Differences in sophistication, etc., among purchasers have no bearing in the impersonal market fraud context, because dissemination of false information necessarily translates through market mechanisms into price inflation which harms each purchaser identically. *See U.S. Financial Securities Litigation, supra,* at 451-452.

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[20]Whether inflation of assets rather than earnings is material to the stock price is for the jury, not us, to decide.

Moreover, because of the relative similarity of the various documents involved, the duty owed by a defendant with respect to such documents will probably be uniform or nearly so, further uniting the positions of all class purchasers.

2. *Predominance and reliance.*

Defendants contend that any common questions which may exist do not predominate over individual questions of reliance and damages.

The amount of damages is invariably an individual question and does not defeat class action treatment. *E.g., U.S. Financial Securities Litigation, supra,* at 448 n.5, and cases there cited. Moreover, in this situation we are confident that should the class prevail the amount of price inflation during the period can be charted and the process of computing individual damages will be virtually a mechanical task. *See* n.24 *infra.*

Individual questions of reliance are likewise not an impediment—subjective reliance is not a distinct element of proof of 10b-5 claims of the type involved in this case.

The class members substantive claims either are, or can be, cast in omission or non-disclosure terms—the company's financial reporting failed to disclose the need for reserves, conditions reflecting on the value of the inventory, or other facts necessary to make the reported figures not misleading. The Court has recognized that under such circumstances

> "involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision. This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact." (citations omitted)

Affiliated Ute Citizens Utah v. United States, 406 U.S. 128, 153-154 (1972). *See U.S. Financial Securities Litigation, supra,* at 451; *Caesars Palace Securities Litigation, supra,* at 399; *In re Penn Central Securities Litigation,* 347 F. Supp. 1327, 1344 (E.D. Penn. 1972).

Moreover, proof of subjective reliance on particular misrepresentations is unnecesary to establish a 10b-5 claim for a deception inflating the price of stock traded in the open market. *See Herbst v. I.T.T., supra,* at 1315-1316; *Chris-Craft Industries, Inc. v. Piper Aircraft Corp.,* 480 F.2d 341, 373-374 (2d Cir. 1973); *Tucker v. Arthur Andersen & Co.,* CCH Fed. Sec. L. Rep. ¶95,107, at 97,934-97,935 (S.D.N.Y. 1975); *U.S. Financial Securities Litigation, supra,* at 449-451; *Werfel v. Kramarsky, supra,* at 681; *In re Memorex Security Cases, supra,* at 100-101; *Siegel v. Realty Equities Corporation of New York, supra,* at 424-425; *Herbst v. Able, supra,* at 20. Proof of reliance is adduced to demonstrate the causal connection between the defendant's wrongdoing and the plaintiff's loss. We think causation is adequately established in the impersonal stock exchange context by proof of

purchase and of the materiality of misrepresentations, without direct proof of reliance. Materiality circumstantially establishes the reliance of some market traders and hence the inflation in the stock price—when the purchase is made the causational chain between defendant's conduct and plaintiff's loss is sufficiently established to make out a prima facie case. *See In re Memorex Security Cases, supra,* at 101; Note, *The Reliance Requirement in Private Actions Under SEC Rule 10b-5,* 88 Harv. L. Rev. 584, 593 (1975).

Defendants argue that proof of causation solely by proof of materiality is inconsistent with the requirement of the traditional fraud action that a plaintiff prove directly both that the reasonable man would have acted on the misrepresentation (materiality), and that he himself acted on it, in order to establish the defendant's responsibility for his loss, which justifies the compensatory recovery.

We disagree. The 10b-5 action remains compensatory; it is not predicated solely on a showing of economic damage (loss causation). We merely recognize that individual "transactional causation" can in these circumstances be inferred from the materiality of the misrepresentation, *see Tucker v. Arthur Andersen & Co., supra,* at 97,933; *Schlick v. Penn-Dixie Cement Corp.,* 507 F.2d 374, 381-382 (2d Cir. 1974), and shift to defendant the burden of disproving a prima facie case of causation. Defendants may do so in at least 2 ways: 1) by disproving materiality or by proving that, despite materiality, an insufficient number of

traders relied to inflate the price; and 2) by proving that an individual plaintiff purchased despite knowledge of the falsity of a representation, or that he would have, had he known of it.[21]

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[21]A number of cases indicate that proof of materiality raises a "presumption" of reliance. The Court did not speak of a presumption in *Mills* or *Affiliated Ute;* we prefer to recognize that materiality directly establishes causation more likely than not, and that reliance as a separate requirement is simply a milepost on the road to causation. The net result is in either view the same; the validity of either view turns on the assumption that the particular investor is more likely to act like the reasonable investor than not.

There is some debate as to whether the "presumption" of reliance may be rebutted; the general view is that it may be, *see* Harvard Note, *supra,* at 600 and 600 n.75, and cases there cited, although sound contrary opinion exists. *See Herbst v. ITT, supra,* at 1316 n.14; *Chris-Craft Industries, Inc., supra,* at 400 (Mansfield, J., concurring and dissenting). The 10b-5 private suit serves a public purpose, but has done so since its judicial creation in the framework of a private damage suit. We doubt the right to disprove causation will substantially reduce a defendant's liability in the open market fraud context, as we doubt that a defendant would be able to prove in many instances to a jury's satisfaction that a plaintiff was indifferent to a material fraud. Nevertheless, we think the public purpose can be adequately served within the traditional compensatory suit framework by limiting recoveries to those who are in fact injured, and excluding those whom a defendant proves have not been injured, and that 10b-5 suits should continue in that mold until a contrary need appears or until the Court directs otherwise.

The right of rebuttal, however, does not preclude the predominance of common questions. Causation as to each class member is commonly proved more likely than not by materiality. That showing will undoubtedly be conclusive as to most of the class. The fact that a defendant may be able to defeat the showing of causation as to a few individual class members does not transform the common question into a multitude of individual ones; plaintiffs satisfy their burden of showing causation as to each by showing materiality as to all.

The right to disprove causation will not render the action unmanageable. A defendant does not have unlimited rights to discovery against unnamed class members; the suit remains a representative one. *See Clark v. Universal Builders, Inc.,* 501 F.2d 324 (7th Cir. 1974); *Gardner v. Awards Marketing Corporation,* 55 F.R.D. 460 (D. Utah 1972); *Fischer v. Wolfinbarger,* 55 F.R.D. 129 (W.D. Ky. 1971). The district judge may reasonably control

That the prima facie case each class member must establish differs from the traditional fraud action, and may, unlike the fraud action, be established by common proof, is irrelevant; although derived from it, the 10b-5 action is not coterminous with a common law fraud action. As we recently recognized in *White v. Abrams,* the fraud action must be and has been flexibly adopted to the overriding purpose of enforcing the Federal securities laws. 495 F.2d at 731. *See Affiliated Ute, supra,* at 151; *Superintendent of Insurance v. Bankers Life & Casualty Co.,* 404 U.S. 6, 12 (1971); *Mills v. Electric Auto-Lite Co.,* 396 U.S. 375 (1970); *SEC v. Capital Gains Research Bureau,* 375 U.S. 180, 186, 195 (1963).

Here, we eliminate the requirement that plaintiffs prove reliance directly in this context because the requirement imposes an unreasonable and irrelevant evidentiary burden. A purchaser on the stock exchanges may be either unaware of a specific false

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discovery to keep the suit within manageable bounds, and to prevent fruitless fishing expeditions with little promise of success. He may also exercise discretion in the conduct of the trial, to prevent a time-consuming series of mini-trials on causation, by limiting introduction of repetitive evidence, or by limiting evidence to instances where causation is in doubt; he may also postpone trial of the rebuttal of individual causation until the damage stage of the trial; indeed, he has extensive powers to expedite the suit with procedural innovations. *See* Rule 23(d). We think procedures can be found and used which will provide fairness to the defendants and a genuine resolution of disputed issues while obviating the danger of subverting the class action with delaying and harassing tactics. If not, we may have to reconsider whether to make proof of causation from materiality conclusive, keeping in mind that the Court has directed that the statute be liberally construed to effectuate its remedial purposes, and that that purpose may be served only by allowing an overinclusive recovery to a defrauded class if the unavailability of the class device renders the alternative a grossly underinclusive recovery.

representation, or may not directly rely on it; he may purchase because of a favorable price trend, price earnings ratio, or some other factor. Nevertheless, he relies generally on the supposition that the market price is validly set and that no unsuspected manipulation has artificially inflated the price, and thus indirectly on the truth of the representations underlying the stock price—whether he is aware of it or not, the price he pays reflects material misrepresentations. Requiring direct proof from each purchaser that he relied on a particular representation when purchasing would defeat recovery by those whose reliance was indirect, despite the fact that the causational chain is broken only if the purchaser would have purchased the stock even had he known of the misrepresentation. We decline to leave such open market purchasers unprotected. The statute and rule are designed to foster an expectation that securities markets are free from fraud—an expectation on which purchasers should be able to rely.

Thus, in this context we think proof of reliance means at most a requirement that plaintiff prove directly that he would have acted differently had he known the true facts. That is a requirement of proof of a speculative negative (I would not have bought had I known) precisely parallel to that held unnecessary in *Affiliated Ute* and *Mills* (I would not have sold had I known). We reject it here for the same reasons. Direct proof would inevitably be somewhat pro-forma, and impose a difficult evidentiary burden, because addressed to a speculative possibility in an area where motivations are complex and difficult to

determine. That difficulty threatens to defeat valid claims—implicit in *Affiliated Ute* is a rejection of the burden because it leads to underinclusive recoveries and thereby threatens the enforcement of the securities laws. *See* Harv. Note, *supra,* at 590-91. Here, the requirement is redundant—the same causal nexus can be adequately established indirectly, by proof of materiality coupled with the common sense that a stock purchaser does not ordinarily seek to purchase a loss in the form of artificially inflated stock.[22] Under those circumstances we think it appropriate to eliminate the burden.

Defendants contend that elimination of individual proof of subjective reliance alters and abridges their substantive rights in violation of the Rules Enabling Act, 28 U.S.C. § 2072. The obvious answer is that the standards of proof of causation we have set out apply to all fraud on the market cases, individual as well as class actions. No interpretation of Rule 23 is involved, and the Rules Enabling Act limitation is not implicated.[23]

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[22] *Raschio v. Sinclair,* 486 F.2d 1029 (9th Cir. 1973), is in no way inconsistent with our present position. There we dealt with the statutory "in connection with" requirement, and held that it could not be met as a matter of law when the stock was purchased two months before the allegedly fraudulent representation was made. Here we do not retreat from that position, or from the implicit requirement set out there that there be a reasonable transactional nexus between the fraud and the loss—we simply amplify on the manner in which that nexus may be proved.

[23] Indeed, we could, in the exercise of our Article III jurisdiction, transform the 10b-5 suit from its present private compensatory mold by predicating liability to purchasers solely on the materiality of a misrepresentation (*i.e.,* economic damage) regardless of transactional causation, without implicating the Enabling Act limitation.

C. *Conflicts.*

Defendants' final major argument is that conflicts among class members preclude class certification. They contend that the interests of class members in proving damages from price inflation (and hence the existence and materiality of misrepresentations subsumed in proving inflation) irreconcilably conflict, because some class members will desire to maximize the inflation existing on a given date while others will desire to minimize it. For example, they posit that a purchaser early in the class period who later sells will desire to maximize the deflation due to an intervening corrective disclosure in order to maximize his out of pocket damages, but in so doing will conflict with his purchaser, who is interested in maximizing the inflation in the price he pays. We agree that class members might at some point during this litigation have differing interests. We altogether disagree, for a spate of reasons, that such potential conflicts afford a valid reason at this time for refusing to certify the class.

Defendants' position depends entirely on adoption of the out of pocket loss measure of damages, rather than a rescissory measure. Under the out of pocket standard each purchaser recovers the difference between the inflated price paid and the value received, plus interest on the difference. If the stock is resold at an inflated price, the purchaser-seller's damages, limited by § 28(a) of the Act, 15 U.S.C. § 78bb(a) to "actual damages," must be diminished by the inflation he recovers from his purchaser. Thus, he is interested in proving that some intervening event,

such as a corrective release, had diminished the inflation persisting in the stock price when he sold.[24]

While out of pocket loss is the ordinary standard in a 10b-5 suit, *Foster v. Financial Technology, Inc.*, ... F.2d ...., No. 73-3203 (9th Cir., April 30, 1975), slip opinion at 3; *Janigan v. Taylor,* 344 F.2d 781, 786 (1st Cir. 1965); *Estate Counseling Service, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 303 F.2d 527 (10th Cir. 1962); *Abrahamson v. Fleschner,* 392 F. Supp. 740, at 746 (S.D.N.Y. 1975); *see Sigafus v. Porter,* 179 U.S. 116, 123 (1900); *Smith v. Bolles,* 132 U.S. 125 (1889); Note, *The Measure of Damages in Rule 10b-5 Cases Involving Actively Traded Securities,* 26 Stan. L. Rev. 371, 383-384 (1974); 3 A. Bromberg, Securities Law, Fraud—Rule

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[24]Appellants contend that the inflation paid must be measured by the change in price after a corrective release. That drop is of course circumstantial evidence of the inflation when purchased, but it is not the exclusive method of measuring inflation. The fact finder may rely on other methods of determining actual value on the date of purchase, including expert testimony on actual value derived from capitalization of earnings techniques or testimony on book value. Particularly where, as here, the amount of inflation due to absence or insufficiency of reserves may fluctuate, such evidence is necessary in the absence of corrective releases. In any event, the drop after a corrective disclosure will not be conclusive of the amount of original inflation, both because the correction may be only partial (as is alleged of the major corrections involved here), and because the prolonged nature of the fraud introduces other market variables which may affect the amount the market reacted to disclosures at different times during the class period. Stanford Note, *infra,* at 384-385; *Tucker v. Arthur Andersen & Co., supra,* at 97,935. However, from an appropriate mix of the various methods we are confident that the jury will be able to trace a graph delineating the actual value of the stock throughout the class period. When compared with a comparable graph of the price the stock sold at, the determination of damage will be a mechanical task for each class member.

10b-5, § 9.1, at 226-227 (1974), it is within the discretion of the district judge in appropriate circumstances to apply a rescissory measure, *Chasins v. Smith, Barney & Co.*, 438 F.2d 1167, 1173 (2d Cir. 1970); *Abrahamson v. Fleschner, supra,* at 746; *see* Stanford Note, *supra,* at 374-376; A. Bromberg, *supra,* at 226, or to allow consequential damages. *Foster, supra,* at 3; *Zeller v. Bogue Elec. Mfg. Co.*, 476 F.2d 795, 802-803 (2d Cir. 1973). It is for the district judge, after becoming aware of the nature of the case, to determine the appropriate measure of damages in the first instance; the possible creation of potential conflicts by that decision does not render the class inappropriate now. The Rule provides the mechanism of subsequent creation of subclasses, Rule 23(c)(4), to deal with latent conflicts which may surface as the suit progresses. *Green v. Wolf Corporation, supra,* at 299; *Tucker v. Arthur Andersen & Co., supra,* at 97,936-97,937; *Handwerger v. Ginsberg,* CCH Fed. Sec. L. Rep. ¶94,934, at 97,241 (S.D.N.Y. 1975); *Caesars Palace Securities Litigation, supra,* at 398; *Sol S. Turnoff v. N. V. Nederlandsche Combinatie Voor Chemische Industrie,* 51 F.R.D. 227, 233 (E.D. Pa. 1970). As a result, courts have generally declined to consider conflicts, particularly as they regard damages, sufficient to defeat class action status at the outset unless the conflict is apparent, imminent, and on an issue at the very heart of the suit. *See Hawk Industries, Inc. v. Bausch & Lomb, Inc.*, 59 F.R.D. 619 (S.D.N.Y. 1973); *Siegel v. Realty Equities Corporation of New York, supra,* at 426.

Here, the conflict, if any, is peripheral, and substantially outweighed by the class members' common interests. Even assuming *arguendo* that the out of pocket standard applies, the class is proper. Every class member shares an overriding common interest in establishing the existence and materiality of misrepresentations. The major portion of the inflation alleged is attributed to causes which allegedly persisted throughout the class period. It will be in the interest of each class member to maximize the inflation from those causes at every point in the class period, both to demonstrate the *sine qua non*—liability—and to maximize his own potential damages—the more the stock is inflated, the more every class member stands to recover. Moreover, because the major portion of the inflation is attributed to causes persisting throughout the period, interim corrective disclosures (of which there appear to have been only two or three) do not necessarily bring predisclosure purchasers into conflict with post-disclosure purchasers. Because both share an interest in maximizing overall inflation, the latter purchaser will no doubt strive to show a substantial market effect from disclosure of the lesser (or partial) causes of inflation to maximize the inflation attributable to more serious causes persisting when he bought—a showing which will increase the recovery of the earlier purchaser. In that light, any conflicting interests in tracing fluctuations in inflation during the class period are secondary, and do not bar class litigation to advance predominantly common interests. Courts faced with the same situation have repeatedly,

either explicitly or implicitly, rejected defendants' position, for the potential conflict is present in most prolonged classes involving a series of misrepresentations. *See Green v. Wolf Corporation, supra; Tucker v. Arthur Andersen & Co.,* at 97,931-97,932 and 97,932 n.14, and cases there cited, and at 97,936; *Aboudi v. Daroff, supra,* at 391-392; *U.S. Financial Securities Litigation, supra,* at 452; *In re Memorex Security Cases, supra; Caesars Palace Securities Litigation, supra; Siegel v. Realty Equities Corporation of New York, supra,* at 426; *Dolgow v. Anderson, supra; Fischer v. Kletz, supra,* at 381-383; *Kronenberg, supra.*

In support of that conclusion, we note that Rule 23 makes no mention of conflicts. The Rule's requirements are that the representative's claims be "typical" and that the class be "fairly and adequately" represented—claims need not be coextensive. *Caesars Palace Securities Litigation, supra,* at 397. Those requirements are in part constitutionally dictated, as due process requires, in order to give collateral res judicata effect to a judgment against class members, that their interests have been adequately represented in the class action. *Hansberry v. Lee,* 311 U.S. 32 (1940).

Hansberry does not, however, as defendants seem to assume, dictate that any divergence of interest among class members violates due process (thereby necessarily requiring an identity of interests to satisfy Rule 23's adequacy or representation and typicality requirements). Neither the Rule's requirements nor those of due process are so inflexible. The due process

touchstone of adequacy and fairness of representation *(see In re Four Seasons Securities Laws Litigation,* 502 F.2d 834, 842 (10th Cir. 1974); *Eisen IV,* at 177) must be judged in light of the seriousness and extent of conflicts involved compared to the importance of issues uniting the class; the alternatives to class representation available;[25] the procedures available to limit and prevent unfairness; and any other facts bearing on the fairness with which the absent class member is represented.

Hansberry is not controlling here—in *Hansberry* there was nothing to satisfy due process. Not only were the members of the purported class of property owners diametrically opposed on the central issue—the validity of racial covenants restricting their property—but the state class action procedure provided absent class members no notice. Here, on the other hand, under the notice and opt-out procedure of Rule 23(b)(3) and 23(c)(2), an absent class member may evaluate his position in the class and decide for himself whether to avail himself of the representation offered. *See, e.g., Four Seasons Securities Laws Liti-*

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[25]The rule requires adequate representation. The alternative may be none at all.

> "The basic concept of commonality, a requirement which is prevalent throughout Rule 23 and is premised upon a fundamental recognition that representatives of a class must have interests which are not in opposition to the members of that class, must be interpreted to best effectuate the primary purposes of the class action device, i.e., to give small investors a reasonable opportunity to vindicate their claims in a manner which will not place an undue burden upon them. It is in this light that we must approach the defendants' objections to the instant class actions under Rule 23(a)(3)." *Caesars Palace Securities Litigation, supra,* at 397-398.

gation, supra, at 842-844; *Herbst v. Able, supra,* at 15. The potential conflicts are at most peripheral. And the district judge will retain constant supervision, through his powers under Rule 23(d) and (e), and through his ability to decertify or create sub-classes, to assure fairness of representation. *See Dolgow v. Anderson, supra,* at 496. Finally, and unlike numerous cases in which even one representative has been held adequate to represent a prolonged class, the class members here will be represented by numerous named representatives, with substantial personal stakes, who purchased throughout the class period, and who thus will probably represent whatever conflicting interests there are in the development of plaintiffs' trial strategies. In light of those various factors, we agree with the district judge that the class representatives are typical and will adequately and fairly represent the class.[26]

AFFIRMED.

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[26]We likewise reject the contention that conflicts between debenture holders and shareholders require decertification at this time; *see Handwerger v. Ginsberg, supra,* at 97,240-97,241; *Caesars Palace Securities Litigation, supra,* at 398-399; *Fischer v. Kletz, supra,* at 384; or that present shareholders and those purchasers who have sold their shares irreconcilably conflict. *See Handwerger, supra,* at 97,240 n.3; *Herbst v. ITT, supra,* at 1314; *Herbst v. Able, supra,* at 15.

Appendix B

In The United States District Court
For The Northern District of California

In Re Consolidated Pretrial Proceedings in Ampex Securities Cases. *This Document Relates to:* Molder (formerly Barrack) File No. C-72521 SW.	Master File No. C-72-360 SW

[Filed April 11, 1974]

MEMORANDUM OPINION AND ORDER

This action is brought by Mrs. Barrack, through her executors, Leonard Barrack, Pearl Singer Molder and Selma Molder, on behalf of herself (now her estate) and all other purchasers of Ampex securities between May 2, 1970 and August 3, 1972. The complaint charges violations of sections 10(b) and 13(a) of the 1934 Securities and Exchange Act, 15 U.S.C. § 78j(b) and § 78n(a) and the Rules 10b-5 and 13 promulgated thereunder, 15 C.F.R. 240.10b-5 and 240.13.[1] Jurisdiction is premised on 15 U.S.C. § 78aa.

[1]The amended Molder complaint also contains a count of breach of fiduciary duty against defendant Roberts brought derivatively under alternative theories of 10b-5 violations and common law. This count has been previously dismissed on defendant Robert's 12(b)(6) motion. Thus the Court will not address any objections to certification based upon this count.

This action is before the Court on plaintiffs' motion to certify a class. It is this motion to which the Court will address itself.

After careful consideration of the volumes of papers submitted, the arguments and authorities on both novel and well worn theories, the Court finds that a conditional class defined as all Ampex security purchasers within the designated 27-month period is warranted. Rule 23(c)(1). The Court, however, on a proper factual showing, reserves the right to reduce or expand the class as to time, types of securities, or types of transactions, to designate appropriate subclasses and to terminate the class. Rule 23(c)(4).

Facts

Although this is extremely complicated litigation not easily summarized, the crux of the allegations is that Ampex and its officers, directors and auditors (Touche Ross) conspired and aided and abetted in misrepresenting, in various publications, the corporation's earnings and financial condition. These publications include, but are not limited to annual reports, interim reports, press releases, and SEC filings.[2] The period of time, over which these violations allegedly occurred and coinciding with the period of this class, commenced May 2, 1970 when the 1970 annual report

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[2]During the 27-month period in question there are claimed to have been 3 annual reports, six quarterly interim reports, 469 press releases and 119 filings with the SEC. Although not definitively narrowed, it seems that the alleged violations involve some 45 of these publications.

issued,[3] and terminated August 3, 1972 when Touche Ross withdrew its certificate.[4]

More specifically plaintiffs claim that defendants misrepresented the corporation's financial security by the deceitful use of certain accounting procedures. It is claimed that the corporation's reports did not reveal specific crucial items, e.g., the true depreciated value of inventories, deferred research and development expenses, accurate asset to liability ratios, contingent liabilities not covered by adequate reserves, and the accurate value of discontinued items. The cumulative effect, according to plaintiffs, was to give the investment community the impression that Ampex was more secure than was perhaps warranted, thus causing its stock to sell at artificially inflated prices. In mid-1972 Ampex reported an approximate $90,000,000 loss.

Plaintiffs further allege that throughout this 27-month period between the initiation of these deceptive practices and the precipitous fall, Ampex took steps to partially correct certain "accounting errors."[5] These corrections allegedly caused downward adjustments

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[3]There appears to be a factual dispute concerning the date of the 1970 annual report. The plaintiffs claim the class begins with the issuance of this document May 2, 1970 but some defendants claim that it did not issue until July 1970.

[4]In this 27-month period there were 570 business days during which there were 120,000 transactions in Ampex securities with a total 21,000,000 shares traded.

[5]Some examples of these partial disclosures are as follows: the announcement March 16, 1971 that the company had not been expensing research and development currently, resulting in a 10.7 million dollar loss; the announcement January 11, 1972 of a 40 million dollar loss due to lack of reserves to cover contingent liabilities, doubtful accounts, and discontinued lines; the announce-

in the value of Ampex securities, but these corrections also allegedly had the effect of lulling investors into believing the corporation's financial position was finally stable when, in reality, more distressing financial news was forthcoming.

The class that plaintiffs seek to represent encompasses all purchasers of Ampex securities within the 27-month period. At this point no one really knows how many members this class would include, although the defendants estimate that it could include upwards of 100,000 investors.[6] The class purportedly includes both past and present shareholders and debenture holders.

Based upon these statistics, all parties agree that the asserted class is so numerous that joinder is impracticable, Rule 23(a)(1), but there is no agreement on the other requirements of Rule 23.[7]

Defendants have raised many potential problems which could affect the viability of this proposed class.

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ment shortly after January 1972 that 40 million was a low estimate of the loss; and the announcement in the 1972 annual report (March, 1972) of an 86 million dollar loss for the whole year.

[6]Of these investors it is estimated that perhaps 35,000 also resold during the period and 46,000 no longer hold Ampex securities.

[7]The § 13(a) claim in Count II cannot proceed as a class action and must be pursued individually by the named plaintiffs. Defendants allege and the Court agrees that private actions for 13(a) violations can only proceed under the authority of § 18(a), 15 U.S.C. § 78r(a). *In re Penn Central Securities Litigation,* 347 F.Supp. 1327, 1340 (E.D. Pa. 1972). Section 18(a) requires by its very language individual, subjective reliance by those seeking relief thereunder. See, *Heit v. Weitzen,* 402 F.2d 909, 916 (2d Cir. 1968). Requiring proof of individual reliance for each class member would necessarily defeat commonness of issues of law or fact and preclude a class action on that count. This does not, of course, preclude the certification of the class for the purposes of the 10b-5 count. Rule 23(c)(4)(A).

Fulfillment of all Rule 23 requirements aside from 23(a)(1), numerosity, has been challenged on several theories. After tedious culling, the Court is of the opinion that the arguments concerning manageability, superiority and adequacy of representation by plaintiffs' attorneys to the extent not handled *infra* lack merit. No doubt management of this class will not be simple, but the Court does not envision the necessity of thousands of days of trial with hundreds of interlocking subclasses before several juries, as feared by defendants.

Any conflicts that Mrs. Barrack's executors as class representatives may have with their role as executors does not affect their ability to represent the members of this class. Whether their role herein would pose a justiciable issue for the estate or beneficiaries thereof would necessarily have to be raised and litigated elsewhere. It does not conceivably create representation problems here.

Other issues raised concerning the competency of plaintiff's counsel to represent this class are unconvincing and not worthy of discussion.

Accordingly, in passing on plaintiffs' motion the Court will only focus on the questions of commonality of fact or law and a number of the alleged conflict of interest problems.

Common Issues of Law and Fact and Predominance of Common Questions

Defendants argue that there is no commonality on the issues in this action because the only commonness

pleaded is conspiracy; that is plaintiffs seek to tie a series of individual wrongs together with a veil of conspiracy. That allegations of conspiracy alone cannot create common issues of fact and law is not disputed. See *Richland v. Cheatham*, 272 F.Supp. 148 (S.D.N.Y. 1967). Although confusingly pleaded, the Court is convinced from the total record that conspiracy is not the lynch pin which holds this cause of action together. Conspiracy is only the device employed by plaintiffs to sweep in the numerous defendants.

The common issues of law and fact and the common issues which predominate are the various alleged misrepresentations and omissions originating in the May 2, 1970 annual report concerning overstated inventory, buried research and development costs and misstated current ration (sic) of assets to liabilities, among other things, creating an erroneous image of prosperity. These possible accounting failings which are alleged § 10(b) violations reappear again in the 1971 annual report along with other alleged misrepresentations. The incidents of fraud were then allegedly repeated and enhanced in the various other publications purported to be links in this chain of misrepresentations. This appears to the Court to be the classic situation of the "standing dominoes" discussed in *Fischer v. Kletz*, 41 F.R.D. 377, 381 (S.D.N.Y. 1966). If it is proved, for instance, that the value of the inventory was materially misrepresented in the 1970 Annual Report, mere proof of the repetition of this overstatement would suffice to prove another violation.

Since this would also be true for each of the alleged representations or omissions, the Court is of the opinion that the allegations constitute a "common course of conduct over the entire period, directed against all investors. . . ," *Harris v. Palm Springs Alpine Estates, Inc.*, 329 F.2d 909, 914 (9th Cir. 1964), cited also in *Fischer v. Kletz, supra* at 381. See also the analysis of the Fischer rationale in *Richland v. Cheatham, supra* at 155.

This case is admittedly more complicated than *Fischer,* with many more potential representations and possible interim intervening curative representations which may or may not eliminate the causal effect of some of the alleged accounting misrepresentations. These complications, although troublesome to the proof of causation and damage, do not militate against this finding of commonness upon the record now before us.

Defendants also argue that actual subjective reliance must necessarily be required before recovery could be granted, especially in a non-privity case such as this,[8] and that in a class this size with many representations at many different times, the diverse issues of reliance alone preclude the existence of common issues of law and fact. Subjective reliance as these defendants urge is not now an element of proof neces-

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[8]The defendants argue forcefully that lack of privity distinguishes this case from those cases which hold that neither subjective reliance nor scientor are required to prevail in 10b-5 suits. They further argue that these elements must be proved and that the application of Rule 23 cannot change this substantive requirement. To the extent it is necessary to decide this issue on this motion the Court finds defendant's arguments unpersuasive. See the discussion in *Grad v. Memorex, cited infra.*

sary to prevail on this action, see *Affiliated Ute Citizens v. United States,* 406 U.S. 128 (1972); see also the discussion in *Grad v. Memorex Corp.,* 61 F.R.D. 88, 97-101 (N.D. Cal. 1973), and thus does not destroy the question of commonness here. The more reasonable reliance theory commonly applied in these large security cases is causal connection or causal nexus. Although proof of the causal nexus between the alleged fraud and the inflated price and the harm incurred will undoubtedly be complex, it neither precludes commonness nor typicality. At this point, the Court also cannot say that it would make this class inherently unmanageable.

Conflicts

First, Ampex argues that the application of the correct damage theory to these facts would create irreconcilable conflict among the members.[9] Assuming *arguendo,* that the appropriate damage formula is out-of-pocket as urged by defendants, and also that the intrinsic value of the stock is measured by the difference between the price immediately before and

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[9]Problems measuring damages are not usually considered in determining a class, *Herbst v. Able,* 47 F.R.D. 11, 17 (S.D.N.Y. 1969); *Grad v. Memorex, supra; Dorfman v. First Boston Corp.,* Civil Action No. 70-1845 (E.D. Pa. 1973), but when, as here, it is purported that the damage theory may affect the causal connection between the alleged fraud and the injury, defeating commonality and typicality the Court will consider it for that purpose only.

Ampex alleges that the plaintiff's damage theory, the difference between the purchase price and the sales price after partial disclosure, is tantamount to rescissory damages and thus inappropriate in a non-privity situation. They further argue that the correct measure would be out-of-pocket, that is the difference the purchase price and the true value at the time of the purchase. It is unnecessary to rule on this point at this time.

the price immediately after the partial corrections, the Court is still unpersuaded that irreconcilable conflicts between the members destroy commonality of issues or render the class unmanageable. After studying the number of examples presented in the papers, the Court is not convinced that the proofs required to prove one member's damage or the plaintiffs' damage operates against the next member's claim or precludes the plaintiff from asserting that member's rights with equal zeal. At this point, there is no reason to believe that the members' various positions are diametrically opposed to each other.

It is further argued that under any theory, assuming causation as pleaded, there is an inherent conflict when one member alleges that he sold at a loss while at the same time another member alleges he bought at a fraudulently induced inflated price. If there was only partial disclosure, it is not inconceivable that one member may be selling out at a loss at the same time one member buys in at a price still inflated due to yet undisclosed fraud. Admittedly these circumstances greatly complicate this case but they do not create obvious conflicts which are irreconcilable.

Neither does the Court find persuasive defendant's arguments that debenture purchasers and stock purchasers cannot be represented by a shareholder and are in such conflict with plaintiff as to preclude any commonality of the issues. Although it is not unimaginable that purchasers of debentures could be influenced by considerations other than those influencing stock investors, see *Carlisle v. LTV Electronics, Inc.,*

54 F.R.D. 237 (N.D. Tex. 1972), the Court at this time is not convinced that these differences exist here.[10] The very nature of the positions of these two security holders does not as a matter of law preclude their inclusion in the same class. See *Fischer v. Kletz,* supra at 384; *In re Ceasars Palace Securities Litigation,* CCH Sec. L.R. § 94,005, 94,049.[11] The Court does concede that there may well have to be a distinct damage analysis employed to determine debenture holders' losses, but these are problems which can be solved with subclasses. They do not frustrate the certification of this class.

Defendants also urge that there is a conflict between those potential class members who purchased within the 27-month period and have since sold all their shares and those who still now hold their shares, because success of this lawsuit would be to the latter's detriment. Again, if these conflicts do prove viable then appropriate subclasses may be the answer. See *Herbst v. Able,* 47 F.R.D. 11, 15 (S.D.N.Y. 1969).

Finally, defendant Touche Ross claims that if a class is certified it should not be allowed to proceed against them, since they were only involved with

[10]The Court has noted that in C-72-360 SW, *Kushner v. Ampex, et al,* consolidated with the subject case for pretrial proceedings, the complainant is a debenture purchaser and complains of exactly the same wrongdoing in the connection and sale of his security as does plaintiff Molder.

[11]*Dolgow v. Anderson,* 43 F.R.D. 472, 492 (E.D.N.Y. 1968) and *Herbst v. Able,* 278 F.Supp. 669 (S.D.N.Y. 1967), relied on by the defendants, do not militate against this finding since they merely found under their particular circumstances and at the stage of their proceedings, these two groups should not proceed together while recognizing that this would not apply to all situations.

Ampex for nine of the 117 weeks in the class period. Even assuming the validity of this assertion, this would appear to be irrelevant to certifying the class. See *Fogel v. Wolfgang,* 47 F.R.D. 213 (S.D.N.Y. 1969). Procedural devices are available to Touche Ross to narrow the issues as to them. Also since this is, as of yet, a conditional class necessary adjustments and subclasses could solve this problem.

In accordance with the findings expressed herein, the Court ORDERS that the plaintiffs' motion to certify this class is HEREBY GRANTED subject to the following conditions:

1. the class shall be defined as all those purchasers of Ampex securities between May 2, 1970 and August 3, 1972;

2. the class is a conditional class subject to adjustments by further order of this Court;

3. the class action is limited to the 10b-5 cause of action stated in Count I of plaintiffs' complaint;

4. and plaintiffs shall bear the cost of notifying the class after Court approval of notice form and timing in accordance with *Eisen v. Carlisle & Jacqueline,* 479 F.2d 1005 (2d Cir. 1973).

Dated: April 10, 1974.

/s/ Spencer Williams
United States District Judge

Appendix C

United Sates Court Of Appeals
For The Ninth Circuit

Leonard Barrack, et al., *Plaintiffs-Appellees*, vs. William Blackie, et al., *Defendants-Appellants.*	No. 74-2141
Benjamin L. Kushner, *Plaintiff-Appellee*, vs. Ampex Corporation, *Defendant-Appellant.*	No. 74-2167
Benjamin L. Kushner, et al., *Plaintiffs-Appellees*, vs. William E. Roberts and John Buchan, *Defendants-Appellants.*	No. 74-2341
Leonard Barrack, et al., *Plaintiffs-Appellees*, vs. Touche Ross & Co., *Defendant-Appellant.*	No. 74-2466
Leonard Barrack, et al., *Plaintiffs-Appellees*, vs. William E. Roberts, et al., *Defendants-Appellants.*	No. 74-2648

[Filed December 16, 1975]

Before: TUTTLE,* KOELSCH and BROWNING, Circuit Judges.

ORDER DENYING PETITION FOR REHEARING AND REJECTING SUGGESTION FOR REHEARING IN BANC

The panel, as constituted in the above case, voted to deny the petition for a panel rehearing. Judges Koelsch and Browning voted to reject the suggestion for a rehearing in banc, and Judge Tuttle has recommended against an in banc rehearing.

The full court has been advised of the suggestion for an in banc hearing, and no judge of the court has requested a vote on the suggestion for rehearing in banc. F. R. App. P. 35(b).

The petition for rehearing is denied, and the suggestion for a rehearing in banc is rejected.

*The Honorable Elbert P. Tuttle, Senior United States Circuit Judge for the Fifth Circuit, sitting by designation.

Appendix D

UNITED STATES CONSTITUTION

AMENDMENT V

Capital Crimes; Double Jeopardy; Self-Incrimination; Due Process; Just Compensation for Property

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

FEDERAL RULES OF CIVIL PROCEDURE

§ 1291. Final decisions of district courts

The courts of appeals shall have jurisdiction of appeals from all final decisions of the district courts of the United States, the United States District Court for the District of the Canal Zone, the District Court of Guam, and the District Court of the Virgin Islands, except where a direct review may be had in the Supreme Court. June 25, 1948, c. 646, 62 Stat. 929; Oct. 31, 1951, c. 655, § 48, 65 Stat. 726; July 7, 1958, Pub. L. 85-508, § 12(e), 72 Stat. 348.

§ 2072. Rules of civil procedure for district courts

The Supreme Court shall have the power to prescribe, by general rules, the forms of process, writs,

pleadings, and motions, and the practice and procedure of the district courts of the United States in civil actions.

Such rules shall not abridge, enlarge or modify any substantive right and shall preserve the right of trial by jury as at common law and as declared by the Seventh Amendment to the Constitution.

Such rules shall not take effect until they have been reported to Congress by the Chief Justice at or after the beginning of a regular session thereof but not later than the first day of May, and until the expiration of ninety days after they have been thus reported.

All laws in conflict with such rules shall be of no further force or effect after such rules have taken effect. Nothing in this title, anything therein to the contrary notwithstanding, shall in any way limit, supersede, or repeal any such rules heretofore prescribed by the Supreme Court. June 25, 1948, c. 646, 62 Stat. 961; May 24, 1949, c. 139, § 103, 63 Stat. 104; July 18, 1949, c. 343, § 2, 63 Stat. 446; May 10, 1950, c. 174, § 2, 64 Stat. 158; July 7, 1958, Pub.L. 85-508, § 12(m), 72 Stat. 348.

Rule 23. Class Actions

(a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the repre-

sentative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

(b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

(1) the prosecution of separate actions by or against individual members of the class would create a risk of

(A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or

(B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or

(2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or

(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the

controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

(c) Determination by Order Whether Class Action to be Maintained; Notice; Judgment; Actions Conducted Partially as Class Actions.

(1) As soon as practicable after the commencement of an action brought as a class action, the court shall determine by order whether it is to be so maintained. An order under this subdivision may be conditional, and may be altered or amended before the decision on the merits.

(2) In any class action maintained under subdivision (b) (3), the court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice shall advise each member that (A) the court will exclude him from the class if he so requests by a specified date; (B) the judgment, whether favorable or not, will include all members who do not request exclusion; and (C) any member who does not request exclusion may, if he desires, enter an appearance through his counsel.

(3) The judgment in an action maintained as a class action under subdivision (b) (1) or (b) (2), whether or not favorable to the class, shall include and describe those whom the court finds to be members of the class. The judgment in an action maintained as a class action under subdivision (b) (3), whether or not favorable to the class, shall include and specify or describe those to whom the notice provided in subdivision (c) (2) was directed, and who have not requested exclusion, and whom the court finds to be members of the class.

(4) When appropriate (A) an action may be brought or maintained as a class action with respect to particular issues, or (B) a class may be divided into subclasses and each subclass treated as a class, and the provisions of this rule shall then be construed and applied accordingly.

(d) Orders in Conduct of Actions. In the conduct of actions to which this rule applies, the court may make appropriate orders: (1) determining the course of proceedings or prescribing measures to prevent undue repetition or complication in the presentation of evidence or argument; (2) requiring, for the protection of the members of the class or otherwise for the fair conduct of the action, that notice be given in such manner as the court may direct to some or all of the members of any step in the action, or of the proposed extent of the judgment, or of the opportunity of members to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or otherwise to come

into the action; (3) imposing conditions on the representative parties or on intervenors; (4) requiring that the pleadings be amended to eliminate therefrom allegations as to representation of absent persons, and that the action proceed accordingly; (5) dealing with similar procedural matters. The orders may be combined with an order under Rule 16, and may be altered or amended as may be desirable from time to time.

(e) Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs.

As amended Feb. 28, 1966, eff. July 1, 1966.

SECURITIES EXCHANGE ACT OF 1934

SECTION 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

RULE 10(b)-5. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

Periodical and Other Reports

SECTION 13. (a) Every issuer of a security registered pursuant to section 12 of this title shall file with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security—

(1) such information and documents (and such copies thereof) as the Commission shall require to keep reasonably current the information and documents required to be included in or filed with an application or registration statement filed pursuant to section 12, except that the Commission may not require the filing of any material contract wholly executed before July 1, 1962.

(2) such annual reports (and such copies thereof), certified if required by the rules and regulations of the Commission by independent public accountants, and such quarterly reports (and such copies thereof), as the Commission may prescribe.

Every issuer of a security registered on a national securities exchange shall also file a duplicate original of such information, documents, and reports with the exchange.

(b) The Commission may prescribe, in regard to reports made pursuant to this title, the form or forms in which the required information shall be set forth,

the items or details to be shown in the balance sheet and the earning statement, and the methods to be followed in the preparation of reports, in the appraisal or valuation of assets and liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the preparation, where the Commission deems it necessary or desirable, of separate and/or consolidated balance sheets or income accounts of any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer; but in the case of the reports of any person whose methods of accounting are prescribed under the provisions of any law of the United States, or any rule or regulation thereunder, the rules and regulations of the Commission with respect to reports shall not be inconsistent with the requirements imposed by such law or rule or regulation in respect of the same subject matter, and, in the case of carriers subject to the provisions of section 20 of the Interstate Commerce Act, as amended, or carriers required pursuant to any other Act of Congress to make reports of the same general character as those required under such section 20, shall permit such carriers to file with the Commission and the exchange duplicate copies of the reports and other documents filed with the Interstate Commerce Commission, or with the governmental authority administering such other Act of Congress, in lieu of the reports, information and documents required under this section and section 12 in respect of the same subject matter.

(c) If in the judgment of the Commission any report required under subsection (a) is inapplicable to any specified class or classes of issuers, the Commission shall require in lieu thereof the submission of such reports of comparable character as it may deem applicable to such class or classes of issuers.

(d)(1) Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class which is registered pursuant to section 12 of this title, or any equity security of an insurance company which would have been required to be so registered except for the exemption contained in section 12(g)(2)(G) of this title, or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940, is directly or indirectly the beneficial owner of more than 5 per centum of such class shall, within ten days after such acquisition, send to the issuer of the security at its principal executive office, by registered or certified mail, send to each exchange where the security is traded, and file with the Commission, a statement containing such of the following information, and such additional information, as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors—

(A) the background and identity of all persons by whom or on whose behalf the purchases have been or are to be effected;

(B) the source and amount of the funds or other consideration used or to be used in making the purchases, and if any part of the purchase

price or proposed purchase price is represented or is to be represented by funds or other consideration borrowed or otherwise obtained for the purpose of acquiring, holding, or trading such security, a description of the transaction and the names of the parties thereto, except that where a source of funds is a loan made in the ordinary course of business by a bank, as defined in section 3(a)(6) of this title, if the person filing such statement so requests, the name of the bank shall not be made available to the public;

(C) if the purpose of the purchases or prospective purchases is to acquire control of the business of the issuer of the securities, any plans or proposals which such persons may have to liquidate such issuer, to sell its assets to or merge it with any other persons, or to make any other major change in its business or corporate structure;

(D) the number of shares of such security which are beneficially owned, and the number of shares concerning which there is a right to acquire, directly or indirectly, by (i) such person, and (ii) by each associate of such person, giving the name and address of each such associate; and

(E) information as to any contracts, arrangements, or understandings with any person with respect to any securities of the issuer, including but not limited to transfer of any of the securities, joint ventures, loan or option arrangements, puts or calls, guaranties of loans, guaranties against loss or guaranties of profits, division of losses or profits, or the giving or withholding of proxies, naming the persons with whom such contracts, arrangements, or understandings have been entered into, and giving the details thereof.

(2) If any material change occurs in the facts set forth in the statements to the issuer and the exchange, and in the statement filed with the Commission, an amendment shall be transmitted to the issuer and the exchange and shall be filed with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(3) When two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a "person" for the purposes of this subsection.

(4) In determining, for purposes of this subsection, any percentage of a class of any security, such class shall be deemed to consist of the amount of the outstanding securities of such class, exclusive of any securities of such class held by or for the account of the issuer or a subsidiary of the issuer.

(5) The Commission, by rule or regulation or by order, may permit any person to file in lieu of the statement required by paragraph (1) of this subsection or the rules and regulations thereunder, a notice stating the name of such person, the number of shares of any equity securities subject to paragraph (1) which are owned by him, the date of their acquisition and such other information as the Commission may specify, if it appears to the Commission that such securities were acquired by such person in

the ordinary course of his business and were not acquired for the purpose of and do not have the effect of changing or influencing the control of the issuer nor in connection with or as a participant in any transaction having such purpose or effect.

(6) The provisions of this subsection shall not apply to—

(A) any acquisition or offer to acquire securities made or proposed to be made by means of a registration statement under the Securities Act of 1933;

(B) any acquisition of the beneficial ownership of a security which, together with all other acquisitions by the same person of securities of the same class during the preceding twelve months, does not exceed 2 per centum of that class;

(C) any acquisition of an equity security by the issuer of such security;

(D) any acquisition or proposed acquisition of a security which the Commission, by rules or regulations or by order, shall exempt from the provisions of this subsection as not entered into for the purpose of, and not having the effect of, changing or influencing the control of the issuer or otherwise, as not comprehended within the purposes of this subsection.

(e)(1) It shall be unlawful for an issuer which has a class of equity securities registered pursuant to section 12 of this title, or which is a closed-end investment company registered under the Investment Company Act of 1940, to purchase any equity secu-

rity issued by it if such purchase is in contravention of such rules and regulations as the Commission, in the public interest or for the protection of investors, may adopt (A) to define acts and practices which are fraudulent, deceptive, or manipulative, and (B) to prescribe means reasonably designed to prevent such acts and practices. Such rules and regulations may require such issuer to provide holders of equity securities of such class with such information relating to the reasons for such purchase, the source of funds, the number of shares to be purchased, the price to be paid for such securities, the method of purchase, and such additional information, as the Commission deems necessary or appropriate in the public interest or for the protection of investors, or which the Commission deems to be material to a determination whether such security should be sold.

(2) For the purpose of this subsection, a purchase by or for the issuer, or any person controlling, controlled by, or under the common control with the issuer, or a purchase subject to control of the issuer or any such person, shall be deemed to be a purchaser by the issuer. The Commission shall have power to make rules and regulations implementing this paragraph in the public interest and for the protection of investors, including exemptive rules and regulations covering situations in which the Commission deems it unnecessary or inappropriate that a purchase of the type described in this paragraph shall be deemed to be a purchase by the issuer for purposes of some or all of the provisions of paragraph (1) of this subsection.

(f)(1) Every institutional investment manager which uses the mails, or any means or instrumentality of interstate commerce in the course of its business as an institutional investment manager and which exercises investment discretion with respect to accounts holding equity securities of a class described in section 13(d)(1) of this title having an aggregate fair market value on the last trading day in any of the preceding twelve months of at least $100,000,000 or such lesser amount (but in no case less than $10,000,000) as the Commission, by rule, may determine, shall file reports with the Commission in such form, for such periods, and at such times after the end of such periods as the Commission, by rule, may prescribe, but in no event shall such reports be filed for periods longer than one year or shorter than one quarter. Such reports shall include for each such equity security held on the last day of the reporting period by accounts (in aggregate or by type as the Commission, by rule, may prescribe) with respect to which the institutional investment manager exercises investment discretion (other than securities held in amounts which the Commission, by rule, determines to be insignificant for purposes of this subsection), the name of the issuer and the title, class, CUSIP number, number of shares or principal amount, and aggregate fair market value of each such security. Such reports may also include for accounts (in aggregate or by type) with respect to which the institutional investment manager exercises investment discretion such of the following information as the Commission, by rule, prescribes—

(A) the name of the issuer and the title, class, CUSIP number, number of shares or principal amount, and aggregate fair market value or cost or amortized cost of each other security (other than an exempted security) held on the last day of the reporting period by such accounts;

(B) the aggregate fair market value or cost or amortized cost of exempted securities (in aggregate or by class) held on the last day of the reporting period by such accounts;

(C) the number of shares of each equity security of a class described in section 13(d)(1) of this title held on the last day of the reporting period by such accounts with respect to which the institutional investment manager possesses sole or shared authority to exercise the voting rights evidenced by such securities;

(D) the aggregate purchases and aggregate sales during the reporting period of each security (other than an exempted security) effected by or for such accounts; and

(E) with respect to any transaction or series of transactions having a market value of at least $500,000 or such other amount as the Commission, by rule, may determine effected during the reporting period by or for such accounts in any equity security of a class described in section 13(d)(1) of this title—

(i) the name of the issuer and the title, class, and CUSIP number of the security;

(ii) the number of shares or principal amount of the security involved in the transaction;

(iii) whether the transaction was a purchase or sale;

(iv) the per share price or prices at which the transaction was effected;

(v) the date or dates of the transaction;

(vi) the date or dates of the settlement of the transaction;

(vii) the broker or dealer through whom the transaction was effected;

(viii) the market or markets in which the transaction was effected; and

(ix) such other related information as the Commission, by rule, may prescribe.

(2) The Commission, by rule or order, may exempt, conditionally or unconditionally, any institutional investment manager or security or any class of institutional investment managers or securities from any or all of the provisions of this subsection or the rules thereunder.

(3) The Commission shall make available to the public for a reasonable fee a list of all equity securities of a class described in section 13(d)(1) of this title, updated no less frequently than reports are required to be filed pursuant to paragraph (1) of this subsection. The Commission shall tabulate the information contained in any report filed pursuant to this subsection in a manner which will, in the view of the Commission, maximize the usefulness of the information to other Federal and State authorities and the public. Promptly after the filing of any such report,

the Commission shall make the information contained therein conveniently available to the public for a reasonable fee in such form as the Commission, by rule, may prescribe, except that the Commission, as it determines to be necessary or appropriate in the public interest or for the protection of investors, may delay or prevent public disclosure of any such information in accordance with section 552 of title 5, United States Code. Notwithstanding the preceding sentence, any such information identifying the securities held by the account of a natural person or an estate or trust (other than a business trust or investment company) shall not be disclosed to the public.

(4) In exercising its authority under this subsection, the Commission shall determine (and so state) that its action is necessary or appropriate in the public interest and for the protection of investors or to maintain fair and orderly markets or, in granting an exemption, that its action is consistent with the protection of investors and the purposes of this subsection. In exercising such authority the Commission shall take such steps as are within its power, including consulting with the Comptroller General of the United States, the Director of the Office Management and Budget, the appropriate regulatory agencies, Federal and State authorities which, directly or indirectly, require reports from institutional investment managers of information substantially similar to that called for by this subsection, national securities exchanges, and registered securities associations, (A) to achieve uniform, centralized reporting of information con-

cerning the securities holdings of and transactions by or for accounts with respect to which institutional investment managers exercise investment discretion, and (B) consistently with the objective set forth in the preceding subparagraph, to avoid unnecessarily duplicative reporting by, and minimize the compliance burden on, institutional investment managers. Federal authorities which, directly or indirectly, require reports from institutional investment managers of information substantially similar to that called for by this subsection shall cooperate with the Commission in the performance of its responsibilities under the preceding sentence. An institutional investment manager which is a bank, the deposits of which are insured in accordance with the Federal Deposit Insurance Act, shall file with the appropriate regulatory agency a copy of every report filed with the Commission pursuant to this subsection.

(5)(A) For purposes of this subsection the term "institutional investment manager" includes any person, other than a natural person, investing in or buying and selling securities for its own account, and any person exercising investment discretion with respect to the account of any other person.

(B) The Commission shall adopt such rules as it deems necessary or appropriate to prevent duplicative reporting pursuant to this subsection by two or more institutional investment managers exercising investment discretion with respect to the same amount.